The INVESTMENT POLICY *of* TRUST INSTITUTIONS

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TO

EVA DAVIS RIDDLE

PREFACE

SUCCESSFUL investment management of property is a difficult problem but one that is essential both from the individual and social points of view. Trust institutions have come to play a dominant rôle in the investment field for they manage billions of dollars of trust property for hundreds of thousands of individuals. The huge amount of savings placed in the hands of these institutions accomplishes nothing until it has been invested. Directing or investing the property intrusted to them constitutes a major function of trust institutions.

Comparatively little has been known regarding the actual investment work of these houses. Consequently this book purports to set forth in a composite study the investment policies and experiences of trust institutions. This study of the investment responsibilities and practices of trust institutions has been made with the idea of subjecting trust investments to the laboratory test in the hope that it will be definitely helpful to trustees and to all people and institutions who are interested in investment.

This book first presents the financial importance of the personal trust business; second, it describes the machinery of trust investing; third, it sets forth some of the legal and economic problems of trust investing; and, finally, it presents a detailed picture of the investment policies, practices and accomplishments of trust institutions for the period, 1919-1932. No attempt has been made to explain how trust property should be invested or to state what investment policy trust institutions should adopt. The book attempts primarily to analyze the way trust institutions have invested the property intrusted to them and what have been the results. It also shows some of the problems involved in carrying on their investment work. Conclusions, if any, may be drawn on the basis of the evidence presented. Certainly this volume represents the experience of the largest and probably the best known trust institutions in the respective areas. Further, the volume of trust property in these districts comprises a large proportion of the aggregate in the United States.

The book is not a study of all personal trusts of all trust institutions. To make such a study would be impossible. It is limited to a representative list of testamentary trusts of various

sizes that have been in operation twelve years or longer extending over a common period of time. These trusts were chosen from various trust institutions in five different states.

Chapters II and III are largely devoted to a description of the machinery of trust investing. An endeavor has been made to present a fairly complete outline of the personal trust investment division although the material of Chapter II is not so comprehensive or detailed as is contained in the manuals of trust investment procedure of a number of institutions. On the other hand the vast majority of trust institutions have a far less elaborate investment organization. It is hoped that the material here presented may be of value in showing the organization and method of operation of a trust investment department. It cannot be denied that a practical and scientific system of investing is one of the greatest needs of a large number of trust institutions. However, it is not implied that any particular system or that a highly elaborate organization alone will invoke sound investing.

The investment work of trust institutions cannot be thoroughly comprehended without an understanding of the legal control of trust investing. In Chapters IV to VIII inclusive, are considered the legal aspects of trust investing in five jurisdictions: New York, Massachusetts, Illinois, Ohio, and Missouri. The invesment provisions of the instruments creating the trusts are set forth in Chapter IV. The statutes bearing upon trust investing in the five States are outlined for each State in Chapter V. Three Chapters, VI to VIII inclusive, comprise an analysis of the court decisions. As compared with other states New York and Massachusetts probably have formulated the most important and substantial body of legal rules setting forth the duties of trustees in trust investing. Therefore, a separate chapter is devoted to the court decisions of each of these States. Although the material is not all-inclusive either as to detailed treatment or as to matters of principle, it is hoped that it will be sufficiently comprehensive that trust people and students may obtain ready information on a large number of problems in the field or that it will furnish a ground work for further study of many of the complicated legal questions bearing upon trust investing. A brief outline only is given of pertinent points in the court decisions of Illinois, Ohio, and Missouri.

The analysis of the investments of 196 testamentary trusts of various sizes from nineteen trust institutions in five states: New York, Massachusetts, Illinois, Ohio, and Missouri is presented in Chapters IX to XIV inclusive. These Chapters form the

backbone of the book. Chapter IX contains an analysis of the trust property of 196 trusts as received by the trust institutions from the grantors. The investment experiences of the institutions in managing these trusts through the period, 1919-1932, are set forth in Chapters X to XIII inclusive. The investment accomplishment with respect to earnings and principal is analyzed in Chapter XIV.

Chapters XV to XXI inclusive comprise a survey of some economic problems confronting trustees in the investment management of trust property.

In the preparation of this book I acknowledge my indebtedness, directly or indirectly, to many individuals, trust institutions, and sources of information. The number of these precludes special mention, except in a few instances. The coöperation and able assistance which a number of trust institutions gave me was of special value and is deeply appreciated. I am also obligated to a number of officers of trust institutions who gave me assistance.

I am gratefully indebted to Professor H. Parker Willis, Columbia University, and Mr. Gilbert T. Stephenson, Vice-President, Equitable Trust Company, Wilmington, Delaware, who read the entire manuscript in its initial form and have given invaluable suggestions for the improvement of the book. Special acknowledgements are also due Professor Henry E. Hoagland, Professor Charles A. Dice, and Professor Harry W. Vanneman of the Ohio State University and to Dr. John M. Chapman, Dr. David L. Dodd and Associate Professor Hastings Lyon of Columbia University, all of whom read portions or all of the manuscript and made helpful suggestions.

Special thanks are also due Mrs. John E. Hallen who has given assistance in reading the manuscript, and has aided in seeing the book through the press. To my wife, above all others, I owe a personal debt for the constant, generous and intelligent help which she has given at all stages of the work.

N. GILBERT RIDDLE.

Columbus, Ohio
August, 1934

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Chapter I

THE RISE AND MAGNITUDE OF THE PERSONAL TRUST BUSINESS OF TRUST INSTITUTIONS

SCOPE OF THE BOOK.—The phenomenal increase in our national wealth has resulted in the acquisition by large numbers of our population of capital for investment purposes. Attendant upon this development has been the impressive growth of personal trust business and the rise of the trust institution in this field. The literature of business contains many studies dealing with these phases of our economic development, especially from the legal point of view. For their purpose, these works are good. In spite of these studies, however, insufficient data have been developed as yet in connection with the question of trust investments. Although trust institutions have under their supervision billions of dollars of individual trust funds, there is little concrete evidence available showing how these funds have been invested. We know very little regarding the classes of investment they have selected, the fields in which they have invested, the diversification of their portfolios, the changes in investment to meet changing economic conditions, the quality of their investments, the investment earnings accomplishment, and whether the principal of the trusts was maintained, increased or decreased. It is therefore, the purpose of this study to present concrete data giving a comprehensive survey of trust institution investments with the following objects in view:

1. To show the source and magnitude of investments of trust institutions.
2. To describe the methods and procedure used by trust institutions in investing trust funds.
3. To set forth the legal aspects of trust investing as exemplified in the five jurisdictions included in this study.
4. To analyze the investment policies and accomplishments of leading trust institutions in New York, Boston, Chicago, Cleveland, and St. Louis as reflected in the investments of 196 testamentary trusts of various sizes.
5. To consider some economic trends and problems of trust investing.

INTRUSTING THE MANAGEMENT OF PROPERTY TO OTHERS.—For centuries individuals who have accumulated wealth have found it necessary at times to delegate or intrust to others the custody or management of their property. Often the need was for an agent only, who, under general directions from the owner, administered a particular property or business committed to his care. Sometimes it was necessary to appoint a trustee with full power to use his own discretion either in full or within certain prescribed limits. The time comes for each man, when, after death, his property must be administered by others, either persons or a corporation of his own choosing, or the appointee of a court. There are several plans by which these objectives may be accomplished through the personal trust department of a trust institution whereby a corporation becomes the administrator of the fund. In the personal trust department the trust institution supervises and manages the investments of individuals under the conditions set forth in any one of the following types of accounts: 1. trusts under wills; 2. trusts under agreements; 3. estate and administration accounts; and 4. agency accounts.[1] The personal trust department mobilizes its funds through the trust institution, being appointed in the capacity signified in any one of the types of accounts mentioned above. The present study is based upon an analysis of the investments contained in testamentary trusts only.

NATURE OF A TRUST.—For our purpose, a trust means a fiduciary relationship in which one person is the holder of the title to property subject to an equitable obligation under which the trustee is bound to keep or use the property for the benefit of certain persons of whom he may himself be one, and any one of whom may enforce the obligation.[2] Thus, the relationship set up in a trust is tripartite, involving the maker or donor, who is called the grantor; the one to whom the legal title passes and is trusted, who is called the trustee, and the one for whose benefit the trust property is held or used, who is called the beneficiary. When a testamentary trust is created there is always a document which has established the relationship. It is a part of the will and is known as the trust instrument. The trust property, which is always an element of a trust, may be any kind of real or personal property that can be assigned at law. In general, the settlor of a trust may be any person competent to make a will, to

[1] Trust institutions administer other types of accounts as well as trusts.

[2] See *Bogert on Trusts,* (1921), pp. 1-5, for a discussion of the definition of a trust and its fundamental terms; Smith, J. G., *Trust Companies in the United States,* (1928), Ch. III; Long, Joseph H., "Definition of a Trust," *Virginia Law Review,* Vol. 8 (1922), pp. 426-33.

enter into a contract, or to deal with the legal title to property. The trustee may be any person who is capable of taking and holding the legal title or beneficial interest in real or personal property.[3]

"Trust" has a very broad meaning, but the use of the term throughout this treatise will have a rather definite and limited application. For our uses it will specify the peculiar relationship that exists between the trustee and the beneficiary. Because of the unlimited confidence which this relation creates, the law requires the utmost good faith on the part of the trustee and the state keeps a jealous eye upon any transaction between the parties. Those trust relationships with which we are particularly concerned deal with the powers of the trust institution as trustee under will.

RISE AND DEVELOPMENT OF TRUST INSTITUTIONS—EARLY PERIOD.—The trust institution is distinctly an American institution, and its history dates from the first quarter of the nineteenth century.[4] The first trust institution of which record has been preserved is the Massachusetts Hospital Life Insurance Company, chartered in 1818. In 1823 it received the express sanction of the state legislature to do trust business. However, the first company which received legislative powers to act in a trust capacity was the Farmers' Fire Insurance and Loan Company, organized in New York in 1822, later known as the Farmers' Loan and Trust Company, and presently the City Bank Farmers Trust Company. The first corporation in the United States to have "Trust Company" as part of its name was the New York Life Insurance and Trust Company chartered by the Legislature of New York in 1830.[5] It is now the Bank of New York and Trust Company.

The early trust institutions, as their titles indicate, were organized primarily as corporations for other purposes and trust powers were granted as a secondary object of incorporation. For example, the first Pennsylvania trust institution was primarily a life insurance company; the first New York trust institution, a fire insurance company; and the first New Jersey corporation, a canal company. In fact, the granting of trust powers to corporations did not mean the beginnings of trust institution service. There was frequently a considerable interval

[3] See *Perry on Trusts,* 7th ed. (1929), for these concepts; also *Bogert on Trusts,* (1921).

[4] See Smith, *op. cit.,* Ch. XII; Stephenson, Gibert T., "Ye Beginnings of Trust Companies in the United States," *Trust Companies,* Vol. 48 (March 1929), p. 343.

[5] *Ibid.*

between the date of the charter and the date of actual be; of trust business.[6] However, by 1830 the Massachusetts H Life Insurance Company of Boston had trust deposits of a] mately $5,000,000.[7] The New York Life Insurance and Company, organized in 1830, had nearly $1,250,000 trust d on March 1, 1831, and over $3,500,000 by 1840.[8]

In this early period the number of trust institutio small; they administered relatively few accounts, and, l of the rather meager supply of capital, they had few oppor to render service as trust institutions. With the sub economic development of the country, individual fortune to multiply and the personal trust business expanded rap that by 1866 nearly a score of trust institutions were in ex On this date trust deposits in New York City were estim aggregate $20,000,000.[9]

After the Civil War economic and business condition oped rapidly and wealth accumulated at an accelerate The enormous increase in the number and size of large f exerted a great influence over the development of trust tions and led to a vast increase in personal trust busine 1891 there were sixty odd trust institutions in the United At that time the personal trust business of all the trust inst in New York State amounted to nearly $100,000,000.[10] E such accounts had grown to $213,500,000 in the State c York.[11]

TRUST INSTITUTIONS ENTER BANKING BUSINESS.—Tl eighties mark the entrance of trust institutions into the l business.[12] As trust institutions entered the field of com banking, they came into direct competition with national l The national banks began to appreciate the advantages ducting a trust business which would bring them ad profits. National banks, however, were not directly trust powers by federal law, but they were able to overco omission by securing a majority interest in the stock of company incorporated under state law. This tendency to c commercial banking and trust business was given official s by the Federal Reserve Act of 1913, which conferre

[6] Stephenson, *op. cit.*, pp. 347-8.

[7] Smith, *op. cit.*, p. 243; for description of "trust deposits" ir periods see Smith, *op. cit.*, Chs. XII, XIII, XIV.

[8] *Ibid.*, pp. 257-8.

[9] *Banker's Magazine*, Vol. 20 (April, 1866), p. 821.

[10] Smith, *op. cit.*, p. 318.

[11] *Ibid.*

[12] *Commercial and Financial Chronicle*, Vol. 36 (Jan. 20, 1883),

[13] *Banker's Magazine*, Vol. 46 (March 1892), pp. 695-6.

national banks the privilege of exercising trust powers. This privilege was further facilitated by the McFadden Act of 1927.

This counter invasion by the national banks into the province of the trust institutions created intense opposition. The opposition hinged on the question as to whether the Federal Reserve Board could grant national banks trust powers if these were conferred by state law upon trust institutions only. After state courts had considered the matter, the Supreme Court of the United States declared that Congress was fully within its rights in granting trust powers to national banks.[14] Thus, trust activi-

TABLE I

GROWTH OF TRUST INSTITUTIONS

LOAN AND TRUST COMPANIES[a]

Year	Number	Capital Funds (millions)	Resources (millions)
1875	35	$ 29	$ 123
1885	40	46	248
1895	242	194	807
1905	683	607	2,867
1915	1,664	1,054	5,873
1920	1,408	1,088	8,320
1925	1,680	1,526	11,566
1929	1,608	2,604	16,155
1930	1,564	2,880	17,703
1931	1,469	2,775	16,861
1932	1,235	2,362	13,119

[a] Compiled from *Annual Reports of the Comptroller of the Currency.*

NATIONAL BANKS EXERCISING TRUST POWERS[a]

Year	Number Having Trust Powers[b]	Number Operating Trust Departments	Capital of Banks Having Trust Powers (millions)	Resources of Banks Having Trust Powers (millions)
1915	356	.....	....	....
1920	1,294	.....	....	....
1925	1,951	.....	....	....
1929	2,461	1,734	$1,218	....
1930	2,465	1,829	....	$23,529
1931	2,329	1,856	1,349	22,619
1932	2,192	1,774	1,277	18,568

[a] Compiled from *Annual Reports of the Comptroller of the Currency.*
[b] Source: Federal Reserve Board.

[14] First National Bk. of Bay City v. Fellows, 244 U. S. 416 (1917); State of Missouri at the relation of the Burnes Nat. Bk. of St. Joseph v. Duncan, 265 U. S. 17 (1924); First Nat. Bk. of San Jose v. State of California, 262 U. S. 366 (1923); First Nat. Bk. in St. Louis v. State of Missouri ex rel. Barrett, Attorney-General, 263 U. S. 640 (1925).

ties of national banks have become firmly established.[15] Ther s now little difference between the trust business of a large t t institution and that of a national bank.

RECENT DEVELOPMENT OF TRUST INSTITUTIONS.—Altho the trust institution came into existence more than one hund years ago, the movement in America as a nationwide projec really only thirty odd years old. Three-fourths of the tr institutions now doing business have come into existence si 1900; the volume of personal trust business has increased e more rapidly.[16] "Since 1905—personal trusts have increa more than four times over."[17] Total trust assets of Penns vania trust institutions have increased from about $500 mill in 1901 to approximately $5 billion in 1932.[18]

Some idea of the development of trust institutions may seen from the striking increase in the number of trust instituti during the last fifty-five years, as shown in Table I on page 5.

POWER TO ENGAGE IN TRUST BUSINESS.—Since a corporat is created by law, it has no natural powers. Its powers derived from a charter which include the certificate of inc poration and the general law under which the corporation formed. Corporate powers include those expressly granted its charter or those implied powers which are necessary for t proper carrying out of the purpose of the corporation.[19] (this point the Supreme Court of the United States said: "V take the general doctrine to be in this country that the pow of corporations organized under legislative statutes are su and such only as those statutes confer. Conceding the ru applicable to all statutes, that what is fairly implied is as mu granted as what is expressed, it remains that the charter of corporation is the measure of its powers, and that the enumer tion of these powers implies the exclusion of all others."[20]

The courts have made it clear that every corporation m exercise certain powers whether they are expressed in the chart

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[15] State courts now generally recognize, as they must, the constit tionality of Section 11(K) of the Federal Reserve Act which grants tru powers to national banks. Hamilton v. State, 94 Conn. 648, 110 A. (1920); Matter of Mollineaux, 109 Misc. Rep. 75, 179 N. Y. S. 90 (1919 In re Turner's Estate, 277 Pa. 110, 120 A. 701 (1923); In re Camerc 287 Pa. 295, 135 A. 295 (1926); Carpenter v. Aquidneck Nat. Bk., 46 R. 153, 125 A. 358 (1924).

[16] See Herrick, Clay., *Trust Companies, Their Organization, Grow and Management,* (1909), Ch. I.

[17] Smith, *op. cit.,* p. 372.

[18] *Annual Reports of Pennsylvania State Banking Department.*

[19] Conyngton, Bennett, Conyngton, *Corporation Procedure,* rev. e (1927), Chs. 1, 3, 5.

[20] In Thomas v. West Jersey R. Co., 101 U. S. 71, 25 L. Ed. 950 (1879

or not. These powers are those required for its corporate existence and those which the corporation must possess in order to accomplish the purpose for which it was formed.[21] In no case, however, are ordinary business corporations granted by statute, either expressly or impliedly, the power to carry on a trust business. Such powers are expressly granted to trust institutions by statute in each state, provided they meet certain requirements. Each state has its own laws governing the creation and supervision of trust institutions within its borders. The organization of trust institutions may be under the general corporation laws of the various states or under a special "Trust Company Law."[22] Where there is a general incorporation law for trust institutions, a trust institution may be organized only for such purposes as are specified in this law. A trust institution created by a special charter may not only perform those services specified thereunder but in some jurisdictions it may also have the powers granted by general law. There is still no uniformity of practice in the several states. The laws vary from those restricting trust institutions to services regarded as strictly trust to those in which trust institutions may perform a wide variety of financial services.[23]

CONDITIONS IMPOSED BY STATUTE.—While the powers of trust institutions vary in different states, they are generally authorized to act as executor, administrator, trustee, guardian, and conservator, provided they comply with certain statutory conditions. The conditions commonly imposed require (1) the trust institution to have a capital of not less than a stipulated amount; (2) that the capital stock and assets of such institutions shall be specially liable for their acts in trust capacities; and (3) the deposit with the proper state official a fund which shall be held as security for the faithful performance by the trustee of the trusts in its charge.

SCOPE OF TRUST POWERS OF TRUST INSTITUTIONS.—The statutes of the various states generally provide that a trust institution which has complied with the requirements of the law shall have any right or power to make any contract, or to accept or execute any trust whatever, which it would be lawful for an individual acting in similar capacities to make, accept or execute.

DUTIES IMPOSED BY STATUTE.—Frequently the state statutes require trust institutions (1) to maintain a distinct organization

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[21] Jacksonville, M. P. R. & Nav. Co. v. Hooper, 160 U. S. 514, 40 L. Ed. 515 (1896); Alton Mfg. Co. v. Garrett Biblical Inst., 243 Ill. 298, 90 N. E. 704 (1910); McCraith v. Natl. etc. Bank, 104 N. Y. 414, 37 A. 932 (1897); *supra*, n. 19.

[22] See *Trust Company Law*, by John H. Sears.

[23] See Prentice-Hall, Inc. *Trust Service*, State Statutes.

for the conduct of trust business which must be separate fı the other departments of the institution, thus preventing mingling of their own property with their trust property; (2) segregate the funds of each trust; (3) to maintain regı accounts of each trust under its administration; and (4) in sc jurisdictions to make regular reports of their trust busin according to a specified form, to the proper state department.

NATIONAL BANKS GRANTED TRUST POWERS.—National ba had no authority to engage in trust business prior to the en: ment of the Federal Reserve Act in 1913. Section 11(K) that Act, as amended by the Act of 1918, grants to the Fede Reserve Board the power "to grant by special permit to natio banks applying therefor, when not in contravention of State local law, the right to act as trustee, executor, adminstrat registrar of stocks and bonds, guardian of estates, assigr receiver, committee of estates of lunatics, or in any other fi ciary capacity in which State banks, trust companies, or otl corporations which come into competition with national baı are permitted to act under the laws of the State in which national bank is located.

"Whenever the laws of such state authorize or permit exercise of any or all of the foregoing powers of State ban trust companies or other corporations which compete w national banks, the granting to and the exercise of such pow by national banks shall not be deemed to be in contravention State or local law within the meaning of this Act."

THE ADVANTAGES OF A TRUST INSTITUTION AS TRUSTEE.— their very nature and size, trust institutions should be in a mı better position to handle investments than the individual. Th officers are presumably trained for the work, and by their co bined knowledge and experience, and complete facilities, tł possess all the essentials for carrying out a sound and intellig investment policy. To determine just how far such a policy carried out and to discuss the problems that arise from time time is the purpose of this book.

MAGNITUDE OF PERSONAL TRUST BUSINESS.—The extent which people have intrusted their property to trust institutic for investment is not known. The hundreds of trust institutic supervising thousands of accounts administer property amounti to billions of dollars.[24] In New York State there are at lea

[24] See Goss, Bert C., "Billions in Personal Trust Funds," *Barron* March 6, 1933, who estimated "that the trust companies of the Uni States are responsible for assets ranging between 25 and 37 billions dollars." If $31 billion, the average figure, is used, the estimate woı not be excessively erroneous.

twelve to fifteen billion dollars in personal trust business. Of the six leading trust institutions in New York City alone, each has over a billion dollars in trust property, while at least four of the six handle approximately two billion dollars of trust accounts. Trust institutions in Pennsylvania had under administration total trust property of $5,127,095,000 in 1931. Two trust institutions in Philadelphia each lists over $900,000,000 in personal trust property; a third company controls over $800,000,000 while the trust institutions of Pittsburgh list $850,000,000 of trust property.[25] Boston trust institutions report assets of the trust department of approximately $800,000,000, nearly 90 per cent of which is held by three trust institutions. Ohio trust institutions have under administration over a billion dollars of personal trust property.[26] Trust institutions in Illinois have an aggregate of $5,304,853,567 of trust property.[27] Each of two Chicago institutions manages personal trust property of nearly a billion dollars. Trust institutions administer probably an aggregate of $1,000,000,000 to $3,000,000,000 or even more, in California, Michigan, Missouri, Maryland, New Jersey and several other states.

As of June 30, 1933, trust departments were being operated by 1,478 national banks,[28] and 100,356 individual trusts were being administered with individual trust assets aggregating $6,311,657,753. Two hundred six national banks were acting as trustees, June 30, 1933, under 617 insurance trust agreements involving the administration of $32,719,615 in proceeds from insurance policies. On the same date, 637 national banks had been named as trustees under 16,358 insurance trust agreements not operative, containing insurance policies with a face value aggregating $696,758,940.

VOLUME OF PERSONAL TRUST ASSETS COMPARED WITH OTHER BUSINESSES.—In view of these huge assets under the control of trust institutions just what is the relative importance of this trusteeship as a part of our economic system? To answer this question we shall make comparisons by using economic standards set up from data in various fields as a contrast, even at the risk of attempting to form equations between factors that are incongruous. In making such comparisons, for instance, it is believed

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[25] *Annual Report of Pennsylvania State Banking Department;* See *Trust Companies,* various numbers, for reports from different financial centers; Smith, *op. cit.,* pp. 371-5.

[26] No official figure is available.

[27] *Trust Companies,* Vol. 56 (March 1933), p. 394.

[28] Data on national banks taken from *Annual Report of the Comptroller of the Currency,* 1933.

that the volume of trust investments held by the personal t departments of trust institutions ranks exceedingly high in scale of the leading businesses—on the basis of capital investe of the country.

Agriculture	\$44,339,000,000[a]
Trust institutions (personal trust property)	31,000,000,000[b]
Manufacturing	29,500,000,000[c]
Railroads	26,087,000,000[d]
Electric power and light	12,800,000,000[e]

[a] *Yearbook of Agriculture,* 1933, p. 4.
[b] This is merely an approximation; actual data are not known. p. 8.
[c] Doane, Robert R., *The Measurement of American Wealth,* (19 p. 10.
[d] Interstate Commerce Commission, 1932.
[e] Bureau of the Census, *Census of Electrical Industries:* 1932.

According to these round figures only one industry of country—agriculture—exceeds the personal trust business trust institutions while only two—manufacturing and railroad approach the figures representing the personal trust business trust institutions. Single industries such as oil, lumber, iron steel, and telephone are only a small fraction of the size of personal trust business. No attempt has been made to estim the personal trust business being administered by individuals.

A comparison of the dollar volume of funds held by differ classes of financial institutions shows that only the commer deposits of all the banks of the country exceed the aggregate the personal trusts supervised by trust institutions. That stupendous personal trusts of these institutions have few count parts among financial institutions, may be seen from the follow enumerations of funds which are held by various classes financial houses:

Commercial deposits	\$41,280,000,000[a]
Trust institutions (personal trust property)	31,000,000,000[b]
Savings deposits	22,683,000,000[a]
Life insurance assets	21,135,000,000[c]

[a] *Annual Report of the Comptroller of the Currency,* (1932), pp. and 88.
[b] See p. 8.
[c] *Proceedings of the Twenty-Seventh Annual Convention of the Am ican Association of Life Insurance Presidents,* N. Y. (1933), p. 61.

RECENT GROWTH OF PERSONAL TRUST BUSINESS.—T growth of trust business within the past few years has be

steadily gathering momentum. According to the Trust Company Division of the American Bankers Association trust appointments of corporate trustees for each of the eight years from 1923 to 1930 were as follows:[29]

Year	Number	Year	Number
1923	5,899	1927	29,814
1924	7,878	1928	44,375
1925	12,926	1929	36,193[a]
1926	19,128	1930	48,812

[a] In 1929 there was a change in the method of calculating appointments.

The annual nation-wide survey of new business figures of the trust departments of trust institutions with trust powers shows that they were nominated executor and for trustee under 26,800 wills in 1928, and under 36,193 wills in 1929, and under 48,812 wills in 1930.[30] These figures represent trust business in hand as distinguished from trust business in prospect.

The volume of trust business represented by this growth in number has not been revealed. However, during 1929, there were 1,086 estates of over $1,000,000 for which trust institutions were named executor or trustee. Thus, slightly more than 1,000 of the total nominations account for over $1,000,000,000 in trust business. Surely the remaining large number of appointments totalled far in excess of this figure.[31]

Appointments in living trusts show a strong upward trend in growth. For 1929, figures from over 560 trust institutions show that they were appointed under living trust agreements 6,295 times. The figure was 9,092 for 1930. The aggregate value of properties in living trusts received in 1929 was $603,926,-218 and in 1930 it was $1,013,769,436. "This represents an increase of 44 per cent in the number of appointments and 67 per cent in the value of properties in new living trusts in 1930 over 1929."[32]

With respect to appointments in life insurance trusts it appears that $1,200,000,000 of life insurance was trusteed in 1929 and $1,560,000,000 in 1930, a 30 per cent increase. It is estimated

[29] These figures are estimates but are based upon reports from various trust institutions to the Trust Company Division of the American Bankers Association. *Proceedings Mid-Winter Trust Conferences,* Feb. 1929-1931.

[30] Stephenson, Gilbert T., "The American Trust Company in 1930." *Proceedings Twelfth Mid-Winter Trust Conference,* Feb. 1931, p. 2.

[31] One writer estimated that "more than 450,000 estates and more than $5,500,000,000 are probated annually by trust companies." Rosenshine, A. A., "The Trust Company and the Public," *Proceedings Eighth Regional Trust Conference,* Aug. 1930, p. 54.

[32] Stephenson, *op. cit.,* p. 3.

that there was over $4,000,000,000 worth of trusteed life insurance at the end of 1930, representing nearly 4 per cent of the total life insurance in force.[33] The amounts of life insurance trusteed during 1928, 1929, and 1930 in some of the centers of population have been estimated as follows:[34]

City	1928	1929	1930
New York	$90,000,000	$175,000,000	$200,000,000
Chicago	75,000,000	100,000,000	
Detroit	70,000,000	70,000,000	70,000,000
Cleveland	55,000,000	65,000,000	55,000,000
Philadelphia	35,000,000	50,000,000	60,000,000
Pittsburgh	32,500,000	45,000,000	47,000,000
St. Louis	29,000,000	33,500,000	37,200,000
Boston	12,500,000	10,000,000	28,783,000
Newark	14,000,000	15,000,000	20,000,000
Los Angeles	10,000,000	10,000,000	15,000,000
San Francisco	7,500,000	12,000,000	17,000,000

There is no published record of the volume of agency business carried on by trust institutions, but it is well known that these institutions have experienced a fair degree of success in this field during the past seven or eight years. The writer is familiar with a number of trust institutions which have developed a larger volume of business under agency accounts than under personal trusts.

The magnitude of the personal trust business of national banks for the years 1929 to 1933 is shown in Table II on page 13.

THE SUPPLY OF CAPITAL.—The vast amounts of wealth placed in trust obviously represent an accumulation of capital from various sources. Just what these sources are and the extent of capital accumulation in the United States may be seen from the following brief survey. On two different occasions attempts have been made to study the distribution of capital in the United States by the use of probate statistics. The first study was a collection of data on the value of estates probated in Massachusetts during various three-year periods.[35] The second study, made by the Federal Trade Commission shows the distribution of capital in the United States, based on a study of probate court records in selected counties in various states of the United States.[36] Data

[33] *Ibid.*

[34] *Ibid.*

[35] King, Willford I., *Wealth and Income of the People of the United States,* pp. 65-100.

[36] Federal Trade Commission, *National Wealth and Income,* 69th Cong., 1st Sess., Senate Doc. No. 126, Ch. III.

TABLE II

PERSONAL TRUST BUSINESS OF NATIONAL BANKS[a]

Number of Trusts Administered by National Banks for Years Ending June 30

Year	Individual Trusts			Insurance Trusts	
	Living	Court	Total	Being Administered	Not Yet Operative
1929	......	......	66,776	271	9,505
1930	......	......	79,912	396	13,543
1931	45,484	46,958	92,442	554	17,656
1932	45,374	48,761	94,135	572	17,824
1933	54,095	46,261	100,356	617	16,358

Value of Assets Administered by National Banks for Years Ending June 30

Year	Individual Trusts (000 omitted)	Insurance Trusts Administered (000 omitted)	Insurance Policies Held Under Trust Agreements Not Yet Operative (000 omitted)
1929	$4,237,649	$11,385	$375,524
1930	4,473,041	13,495	586,706
1931	5,241,991	21,668	734,831
1932	4,642,065	25,573	732,498
1933	6,311,658	32,720	696,759

[a] Compiled from *Annual Reports of the Comptroller of the Currency.*

were secured for a total of 43,512 estates from county probate court records in Massachusetts, New Hampshire, Maryland, District of Columbia, North Carolina, Georgia, Texas, Oklahoma, Kansas, Idaho, Iowa, Wisconsin, and North Dakota. The selection of the counties was made with a view not only as to their geographical distribution but also as to their representation of three general population types, namely, rural, town and city. For each county selected, a report was made on every estate probated in the twelve-year period, 1912-1923, inclusive. There was also secured special and detailed information from probate records on all reported estates of $1,000,000 and over for a six-year period, 1918-1923, inclusive, embracing New York, Philadelphia, and Chicago. The information thus compiled was supplemented with data obtained by the estate tax division of the Bureau of Internal Revenue.[37] The results of the Federal Trade Commission Study are presented in Table III on page 14.

These studies give some idea of the nature and extent of the potential demand for personal trust service of trust institutions. The Federal Trade Commission figures show that the total value of estates less than $5,000 is only 6.8 per cent of the aggregate

[37] *Ibid.*, pp. 56-7.

TABLE III

DISTRIBUTION OF ESTATES PROBATED IN SELECTED COUNTIES OF THE UNITED STATES, 1912-1923[a]

1	2	3	4	5	6	7	8
Value of Estates in Class ($000's)	Number of Estates in Class	Per Cent of Total Number of Estates	Total Value of Estates in Class ($000's)	Per Cent of Total Value of Estates	Column 3 Cumulated from Top	Column 5 Cumulated	
						From Top (%)	From Bottom (%)
Under 5	6,099	14.0	1,575	0.2	14.0	0.2	100.0
0.5 but under 1.0	4,824	11.1	3,388	0.5	25.1	0.7	99.8
1.0 but under 2.5	8,766	20.2	14,196	2.1	45.3	2.8	99.3
2.5 but under 5.0	7,572	17.4	26,934	4.0	62.7	6.8	97.2
5.0 but under 10.0	6,446	14.8	45,161	6.7	77.5	13.5	93.2
10.0 but under 25.0	5,518	12.7	85,234	12.7	90.2	26.2	86.5
25.0 but under 50.0	2,231	5.1	77,930	11.6	95.3	37.8	73.8
50.0 but under 100.0	1,105	2.5	76,040	11.3	97.8	49.1	62.2
100.0 but under 250.0	651	1.5	97,600	14.6	99.3	63.7	50.9
250.0 but under 500.0	179	.4	60,326	9.0	99.7	72.7	36.3
500.0 but under 1,000.0	76	.2	52,027	7.8	99.9	80.5	27.3
1,000.0 and over.	44	.1	130,913	19.5	100.0	100.0	19.5
Totals	43,512[b]	100.0	671,323	100.0			

[a] Federal Trade Commission, *National Wealth and Income, 69th Cong., 1st Session, Senate Document, Number 126, p. 58* (Columns 6, 7, and 8 supplied by writer.)

[b] Column 2 totals 43,511; error in the source material.

value represented by the 43,512 estates probated. Thus, 62.7 per cent of the number of estates probated constituted only 6.8 per cent of the total capital represented by the 43,512 estates probated. The estates smaller than $10,000 made up 77.5 per cent of the total number of the estates probated, but the aggregate value of all these estates constituted only 13.5 per cent of the assets represented by the total of the 43,512 estates probated. The estates probated ranging from $10,000 to $50,000 included 17.8 per cent of the number of estates, but in the aggregate constituted 24.3 per cent of the total amount of property probated. Estates probated ranging from $50,000 to $250,000 included 4 per cent of the number of estates, but in the aggregate constituted 25.9 per cent of the total amount of property probated. There were only 299 estates out of the 43,512 which were over $250,000; 120 exceeded $500,000. The 299 estates over $250,000 as a composite constituted 36.3 per cent of the total property probated while the 120 estates over $500,000 aggregated 27.3 per cent of the total property probated. The forty-four estates over $1,000,000, represent 19.5 per cent of the total property probated.

According to the Federal Estate Tax reports, from September 9, 1916, to December 31, 1931, approximately 152,000 returns were made for an aggregate of about $42,000,000,000. When death occurred prior to February 26, 1926, the gross value of each of the estates amounted to $50,000 or more; when death occurred after that date the value amounted to $100,000 or more each. For 1930 there was a record of 8,798 estates passing by death with a gross value of about $4,108,517,000. The number of returns filed during 1931 in behalf of resident decedents was 8,333 with an aggregate value of $4,042,381,000. It is estimated that probably more than 3,000 persons with gross estates between $50,000 and $100,000 died during 1927. Thus, the estates above $50,000 gross value which passed by death in 1927 totalled a trifle less than $3,500,000,000. It is further estimated that more than 385,000 individuals die annually, with estates smaller than $50,000 which are also administered. These estates have an aggregate value of over $1,650,000,000. These figures reveal that a grand total of approximately 400,000 estates with a total value of about $5,150,000,000 passed by death in 1927 which were administered within the United States.[38]

While trust institutions are vitally interested in probate

[38] McCoy, Joseph S., "What the Federal Estate Tax Returns Reveal," *Proceedings Tenth Mid-Winter Trust Conference*, February, 1929, p. 81; "The Growing Field for Trust Service," *Proceedings Eleventh Mid-Winter Trust Conference*, February, 1930, p. 34; *Statistics of Income.*

records and estate tax reports in connection with testamentary trusts, executorships and administratorships they are also concerned with the distribution of capital among living persons as a source of business in connection with various types of living trusts and agencies.

Fortunately there are some substantial data on this point. Within the last decade, a statistical study was made to determine the distribution of capital among the living, this study being based upon a complete analysis of all available data. According to this study there were 40,908,324 property owners in the United States as of December 31, 1921, and the total aggregate capital was estimated at $281,157,000,000.[39] The distribution of capital as estimated by King is shown in Table IV on page 17.[40]

According to these data, individuals owning from $1,000 to $10,000 constitute 76.3 per cent of all property owners, or over 30,000,000 people; this group of individuals owns 33.6 per cent of the total capital of the United States. The people owning from $10,000 to $50,000 constitute 9.2 per cent of all property owners, and in the aggregate they possess 27.85 per cent of the total capital of the United States. The groups from $50,000 to $100,000 own 9.1 per cent of the total capital of the United States and constitute 0.9 per cent of the property-owning class. An aggregate of 28.1 per cent of the total capital of the United States is owned by individuals worth $100,000 or over who constitute only 0.63 per cent of the total property-owning population.

A further idea of the potential supply of personal trust funds may be gained from an examination of the amount of life insurance which has been written. In 1900, the total amount of life insurance in force in the United States was $8,560,000,000. By December 31, 1933, the total amount had increased to over $100,000,000,000.[41] The volume of savings deposits in the United States is also a very significant item in illustrating the growth of wealth. The aggregate of savings deposits in savings banks and in state and national banks amounted to $22,683,488,000 on June 30, 1932.[42]

[39] King, W. I., "Wealth Distribution in the Continental United States," *Journal of the American Statistical Association*, Vol. 22 (June 1927), pp. 135-53.

[40] While these figures represent conditions twelve years ago, the situation has not appreciably changed since that time. See Doane, Robert R., *The Measurement of American Wealth*, (1933), Ch. II.

[41] *Proceedings Twenty-Seventh Annual Convention of the American Association of Life Insurance Presidents*, New York, 1933; The Spectator Company.

[42] *Report of the Comptroller of the Currency*, 1932, p. 88.

TABLE IV

DISTRIBUTION OF WEALTH AMONG PROPERTY OWNERS IN THE UNITED STATES,

December 31, 1921

1	2	3	4	5	6	7
Wealth per Person	Number of Persons in Class	Per Cent of Total Number of Persons in Class	Total Capital of each Class ($000,000)	Per Cent of Total Capital in each Class	Column 3 cumulated from bottom	Column 5 cumulated from bottom
0 up to.......$ 600	1,798,572	4.396	767	0.273	100.0%	100.0%
600 up to....... 1,000	3,489,806	8.53	2,815	0.997	95.60	99.727
1,000 up to....... 2,400	15,665,781	38.29	25,973	9.24	87.07	98.73
2,400 up to....... 10,000	15,564,851	38.04	68,573	24.39	48.78	89.49
10,000 up to....... 25,000	2,634,660	6.44	40,840	14.53	10.73	65.10
25,000 up to....... 50,000	1,124,350	2.748	37,455	13.32	4.29	50.57
50,000 up to....... 100,000	371,100	0.91	25,619	9.11	1.54	37.25
100,000 up to....... 500,000	230,520	0.56	46,844	16.66	0.63	28.14
500,000 up to....... 1,000,000	21,450	0.052	14,439	5.14	0.070	11.48
1,000,000 up to....... 2,500,000	5,800	0.0142	7,518	2.67	0.018	6.34
2,500,000 up to....... 5,000,000	785	0.0019	2,779	0.99	0.0035	3.67
5,000,000 up to....... 10,000,000	345	0.00084	2,224	0.79	0.0016	2.68
10,000,000 up to....... 20,000,000	269	0.00065	3,680	1.31	0.00074	1.89
20,000,000 and over	35	0.00009	1,631	0.58	0.00011	0.90
Total	40,908,324		281,157			

The Nature of Trust Investing.—The investment of trust assets by trust institutions today is a particularly difficult task involving the consideration of many factors which do not ordinarily concern other institutions. Trust investments cannot be measured by the same analytical methods that are applicable to the investments of insurance companies, savings or commercial banks, and other similar financial institutions. The funds of the latter have been received in the form of cash, and there is only one portfolio to supervise and keep invested. Their objective is to maintain and increase the dollar value of the principal and income, hence these institutions may carry out a deliberately planned and unified scheme of investing.

Trust institutions on the other hand, have as many different investment problems as they have accounts. Each trust account is a distinct unit requiring a separate portfolio of investments, which must be altered or amended to suit the individual need. No two investment requirements are alike—what might be good for one would be a poor investment for another. The trust institution has a variety of different types of accounts; one type for the widow and the orphan; one for the conservative investor; and still another for the one who desires an income as high as safety permits. Thus the trust institution must not only invest scientifically, but also for the purpose of satisfying the particular requirements of beneficiaries in hundreds of thousands of accounts. Another troublesome problem confronting the trust institution is the disposition of investment items found in the inventory of trust assets, handed over to it by the creator of the trust. The original portfolio sometimes consists of only a single type of investment, or it may all be in cash, but more often it contains a heterogeneous collection of stocks, bonds, real estate and real estate obligations which are of doubtful quality or have severely depreciated in value.

Trust investing is further complicated by the fact that there are varying sums to be invested, ranging in size from a few thousand dollars to over a million dollars. Certainly, an investment policy suitable for a $5,000 or $10,000 account would not apply to trusts of a different nature and of much larger amounts. There is likewise the time element to be considered—the trust may run for a short period—a few years or less—or it may continue for half a century or even longer. Again, the duration of the trust may be unknown, for it may be terminated at any moment by some unforseen contingency.

Then, too, there are several factors which militate against the flexibility and freedom of action on the part of the trustee,

who is responsible for the investments. In the first place, the donor frequently imposes specific restrictions regarding the investments handed over to the trustee, or in the making of new investments. The terms of the instrument, of course, must be followed implicitly—it is true that the trustee, in many cases, is given broad powers in making investments, but he must always be "reasonable, prudent and diligent," or be liable for any loss that occurs through his negligence. In the second place, the investment of trust funds is often circumscribed by statutory law and court decisions—hence, if no discretionary powers appear in the trust instrument, the trustee must abide by the law, or be guided by the precedents prescribed by statute or established in court decisions.

Thus, on all sides the trust institution is beset with manifold problems in any attempt to formulate an intelligent program for the investment of trust funds. This task is made difficult enough by the conflict of laws and opinions regarding the handling of fiduciary investments, but the presence of such a multiplicity of accounts makes it well nigh impossible to follow any unified procedure for the whole in diversification, marketability, safety, or appreciation. The thousand and one questions that arise from time to time in the selection and analysis of proper securities for each trust account call for constant study of the entire field of investment, and require the undivided attention of trust officers if they would keep apprised of the most suitable media as outlets for trust funds.

Chapter II

THE MECHANISM OF INVESTING BY TRUST INSTITUTIONS

THE investment of trust funds is one of the most important functions of the trust department. By it is largely measured the success of the organization. For a short time, perhaps, a trust department may achieve apparent success regardless of its investment practices, but in reality there cannot be sustained success unless a sound investment policy is adopted and followed. An investment policy to meet present-day needs is predicated upon a thorough knowledge of the principles of investment, a sound up-to-date understanding of fundamental economic and business conditions, a clear appreciation of the conditions affecting the trend of industry, commerce and business in general, and adequate information about individual corporations and their various securities. The trust investment organization, therefore, is confronted with a complexity of factors in its performance of the investment function. Just what these factors are and the step-by-step procedure in handling trust accounts it will be the object of this chapter to show.[1]

THE FUNCTION OF THE TRUST INVESTMENT DIVISION.—The function of the trust investment division is primarily to assist the administrative officers in the investment management of the various accounts of the trust department. The degree of responsibility and control exercised is predicated upon the capacity in which the institution acts and the nature of the particular account. In general, the duties of the trust investment division with respect to the various accounts may be listed as follows:[2]

1. Investment and reinvestment of trust funds; selection of investments and entering of orders.

[1] Material for this chapter was developed from a personal study of the trust investment division of various trust institutions. The author has made frequent use of the manuals of trust investment procedure from several of these institutions. In order to avoid the identification of individual institutions specific credit is not given for most of the material of this chapter.

[2] No attempt is made to give an outline of duties with respect to each class of accounts.

2. Periodic review of each account as to the merits of the investments and diversification.
3. Analysis of securities, companies, and industries as affected by economic and business conditions.
4. Elimination of undesirable investments. Choosing the securities to be sold and the entering of orders.
5. Handling securities with reference to changes in dividends, calls for redemption, exchanges, conversions and stock rights.
6. Investigation and follow-up of defaulted securities.
7. Determining a policy regarding securities held which are involved in consolidations, reorganizations, bondholders' protective agreements, and giving instructions for carrying out the policy determined upon.
8. Consultation and correspondence with customers respecting all investment matters pertaining to their accounts.
9. Maintaining such records of its activities as will provide evidence at any future time that the decisions taken, whether or not profitable to the account, were reached after careful consideration of the best information available at the time.

TRUST INVESTMENT ORGANIZATION—OFFICIAL IN CHARGE OF TRUST INVESTMENT DIVISION.—A vice-president or other officer is in charge of the trust investment division. He directs the general investment policies, has the responsibility for general supervision over trust investments, coordinates the functions of the administrative group and the trust investment division, and presides at meetings of several investment committees. In special instances he may consult with customers. Where the occasion demands, the officer in charge may be assisted in these duties by another officer.

CLASS OF ACCOUNTS AND INVESTMENT OFFICERS.—The accounts of the trust investment division to which its services are primarily devoted may be classified into four groups:[3]

1. Trusts under wills.
2. Trusts under agreements and insurance trusts.
3. Estate and administration accounts.
4. Agency accounts.

To each of these groups of accounts there is assigned an investment officer who has, in general, three duties. The first is to

[3] The writer has noted similar classifications in a number of institutions.

supervise investments for his group of accounts. However, he does not have final authority, except in certain emergency cases, but he is directly charged with the duty of presenting for action to those in whom authority rests, all matters pertaining to trust investments. He is also responsible for carrying out the recommendations made by the investment committees. Obviously he should understand the trust business and have a thorough knowledge of investments. The second broad duty of the investment officer is to keep in close touch with the administrative officers. Lastly, he should consult with customers in regard to the securities held in their accounts.

ORGANIZATION OF THE TRUST INVESTMENT DIVISION.—The work and operating force of the trust investment division proper is under the direction of the manager. He has the responsibility of seeing that the functions of the division are carried out properly from the viewpoint of personnel and procedure. For operating purposes the trust investment division is divided into four main sections:

1. The review section. The accounts in the groups described above are assigned to reviewers who work directly with the investment advisors and handle all details with reference to the accounts assigned to them, including the periodic review of securities.
2. The statistical section. This consists of a group of analysts who analyze securities by class, individual securities, industries and economic conditions—all factors affecting the securities held, including delinquencies and bondholders' protective agreements.
3. The information and records section. This section maintains the trust-synopsis sheet, the various ticklers, investment folders, security records, company-information folders, files of economic and statistical information, statistical and investment services, and periodicals and investment literature.
4. The trading section. This section handles the entering of all orders to purchase or sell investments.

THE INVESTMENT COMMITTEES.[4]—The decisions as to actions to be taken with reference to the securities held in the various accounts or the investing of funds are made for the most part by one of the investment committees.

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[4] See *A Handbook for the Review and Survey of Trust Securities,* Trust Company Division, American Bankers Association, (1930), pp. 4 ff.

THE INVESTMENT COMMITTEE.—For each section of accounts supervised by an investment officer, there is an investment committee composed of the administrative officer to whom the account is assigned, the officer assisting the official in charge of the trust investment division, the senior analyst, and the investment officer. Each investment committee meets weekly to consider the accounts which are brought up for review and any special problem affecting the accounts supervised by that investment committee.

THE CENTRAL INVESTMENT COMMITTEE.—There is a central investment committee which supervises the investment work of the investment committees. The central investment committee consists of the members of the investment committees, the officer in charge of the trust investment division, the officer in charge of the classification of accounts involved, and one of the other senior vice-presidents of the trust department. The committee meets weekly to pass upon the recommendations of the investment committees and to make the final decisions as to the action to be taken.

THE GENERAL INVESTMENT COMMITTEE.—The members of this committee are the vice-president or officer in charge of the trust investment division and the officer assisting him, the other senior vice-president of the trust department, a representative from the commercial department, all the investment officers in charge of a class of accounts, the manager of the trust investment department, and the senior analyst. This committee meets weekly for the purpose of coordinating policies and operations, makes final decisions on general investment policies, considers securities held in several classifications of accounts, considers reports on industries, passes upon the securities placed upon the list of those approved for trust investments, examines new trusts, authorizes all purchases and sales, and in general, guides the whole trust department operation.

There is a secretary of the investment committees who attends all meetings of these committees. He keeps the minutes of each meeting and advises the various parties interested as to actions decided upon, so that the actions may be carried out.

THE COMMITTEE ON INVESTMENTS OF THE BOARD OF DIRECTORS.—This committee is usually composed of five directors of the trust company, who meet weekly with the senior vice-presidents of the trust department. The committee makes a general survey of the work of the trust investment division and approves all securities to be bought or sold and all investment programs. There is submitted to this committee for decision, questions of

important investment policies, unusual or difficult situations in accounts, complicated problems with reference to securities, and special problems growing out of the industrial cycle and economic conditions. The officer assisting the official in charge of the trust investment division acts as secretary at these meetings.

The conclusions of this committee on investments are written into formal minutes, and the entire matter is then submitted to the board of directors of the trust company for approval.

EQUIPMENT OF THE TRUST INVESTMENT DIVISION.[5]—The trust investment organization cannot carry through an investment program unless it has the requisite equipment and information. The following outline indicates the desirable equipment for this work:

SYNOPTIC RECORD.—This information sheet gives a brief synopsis of the trust agreement and the information pertinent in the management of an account. It includes a summary of the provisions governing investments, the conditions upon which the account terminates, its size, a brief history of the beneficiary as to business factors, residence and citizenship, type of account and purpose.

SECURITY RECORDS.—There should be complete files of all the investments in the accounts. These records may be divided in three ways: (1) by accounts, (2) by securities, and (3) by companies. The divisions by accounts and by securities may be again divided into (a) stocks, (b) bonds, (c) real estate obligations and (d) miscellaneous. Each card contains the following information: number of the account, name of the customer, name of the individual security, the income-paying dates, the date of the transaction, the description, the certificate number, the registration of the certificate in the case of stocks, the share or par balance, the unit-cost, the debit, credit, and balance. There is maintained in addition to these security records, a card-file of companies, the securities of which are held by the trust department, to facilitate the work of the analysts in reviewing economic conditions as they affect certain industries. These files provide a system of index-card records so that they may be found in groups by any classification. A card is made up for each company and filed alphabetically by the name of the company. These cards are in turn classified as to railroads, utilities industrials, government, real estate, real estate obligations, and miscellaneous. Each of these fields of investment is further classified. Railroads are divided into geographic groups or in

[5] See *A Handbook for the Review and Survey of Trust Securities* Trust Company Division, American Bankers Association, (1930), part IV

some other manner for convenience. Utilities are classified according to the nature of the business, such as electric power and light, gas, traction, water, telephone and telegraph. The industrial group is further classified according to the nature of the business in which the company is engaged, comprising some thirty odd classes of industries. Where possible, real estate issues may be classified according to the house of issue; however, if more convenient, they may be classified according to the business they represent. Foreign bonds may be classified according to the location of the debtor government.

By the use of this file, the analysts are in a position to review situations rather than individual securities. To illustrate, if a change in general business conditions should occur, adversely affecting the copper industry, the analysts could, by the use of this file, ascertain the names of all companies in the industry the securities of which are held in the trust department.

INVESTMENT FOLDER.—There should be an investment folder for each account. All memoranda and correspondence relating to the securities in the account, all copies of "securities-received" and "securities-delivered" tickets, reviews of securities, and minutes of the investment committees relating to the account are placed in the investment folder.

TICKLERS.—Ticklers are maintained for the following items: 1. maturing bonds, 2. clipping coupons, 3. checking dividends, 4. conversion features, 5. stock purchase warrants, 6. privilege subscriptions, etc. These ticklers provide a check on all the above features or on any other special factors which may be significant in investing.

COMPANY INFORMATION FOLDERS.—There should be a folder for every important, or relatively important, company in all the investment fields. It provides a place for all information concerning the various companies, such as financial statements from the company, statistical reports, news clippings, special articles, reports written by an analyst, and all correspondence with the company. This material, considered with the published statistical and investment information contained in the usual manuals and services, may greatly assist in the analysis of a company, security, or special situation.

ECONOMIC AND STATISTICAL INFORMATION FILES.—As a background for investment analysis, there should be fairly complete and accurate information regarding economic, industrial and financial conditions. There should be available information, statistical or otherwise, covering general business conditions, production in every field, trade and commerce, and finance. In addi-

tion to this material, it is vitally important to have all data and material possible concerning specific industries such as electrical equipment, oil, chemical, real estate, electric power and light, etc.

INVESTMENT AND STATISTICAL SERVICES.—It is essential to have certain investment and statistical services. The manuals, special services, bond records, etc., should be part of the equipment of the trust investment department.

PERIODICALS, INVESTMENT LITERATURE, AND LIBRARY SERVICE.—The various financial magazines, periodicals, business and trade journals, investment literature, and reference material are highly important in carrying on investment work.

TRUST INVESTMENT PROCEDURE[6]—NEW ACCOUNTS.—When a new account is opened, the account information division sends to the manager of the trust investment division copies of the synoptic record which has been prepared under the direction of the administrative officer, who is assisted by the investment officer. A copy goes to the investment folder file-clerk, one to the investment officer, and one to the officer assigned to the account. An additional copy is circulated among these parties for instructions to be carried out, and is then forwarded to the reviewer who has been assigned to the account.

When informed by the synoptic record of a trust which requires an annual review, the investment advisor sends a memorandum to the addressograph department requesting that the addressograph plate, showing the name of the account, be tabbed in such a way that when the plate is run on the date set, it will be selected and printed on a list. If the account requires reviews in addition to the annual reviews, ticklers are set up to call attention to such requirements at the times indicated. Addressograph lists are made up twice a month in duplicate for all accounts tabbed for selection at the particular period. One copy is sent to the investment officer and one to the secretary of the investment committees. In this way all accounts are reviewed immediately after they are opened and periodically thereafter as required.

REVIEW OF ACCOUNTS.—In performing investment work, there should always be kept in mind as guides the purpose of the trust and the investment policy, the two harmonizing, of course. With these important factors in mind, attention may next be focused upon the analysis of the trust as a whole.

When an account is to be reviewed, either when it is opened, or subsequently when it is brought to attention for a periodical

[6] Much of the remainder of this chapter is summarized from the manuals of trust investment procedure of various trust institutions.

review, or because of a certain situation, the investment officer informs the reviewer who has charge of that account. The latter prepares a requisition, directing the addressograph division to run the addressograph plates showing the securities held in the account on an investment sheet.

The investments are classified into the following groups in the order mentioned: bonds, preferred stocks, common stocks, real estate obligations, real estate, and miscellaneous. Within the groups the securities are arranged in accordance with the classifications of enterprises in alphabetical sequence. The classification of enterprises is as follows: bonds—United States government, state and municipal, railroad, public utility, industrial, land bank, foreign; preferred stocks—railroad, public utility, industrial; common stocks—railroad, public utility, industrial, bank, miscellaneous; real estate obligations—real estate bonds, real estate loans, promissory notes; real estate is not classified; miscellaneous is not classified.

The reviewer gathers the data and fills in the spaces across the sheet for each investment item. The data required includes description of issue, par value, market price, rate, yield, annual income, and rating. The investment sheet is then submitted to the investment officer, who surveys the entire account, looks over the securities, and sends a request to the manager of the trust investment division for analytical reports covering specific securities, companies, situations and the account as a whole. Instructions are then given to the reviewer and to an analyst to gather the necessary information and to make the required reports.

When the data are collected and properly entered on the investment sheet, a general review of the account is made. The general review gives consideration to such salient features as investment quality, diversification, marketability, current return, and general suitability to the requirements of the beneficiaries and the purpose for which the trust was established.

Following up the general review, a short written analysis on each security is prepared wherever the situation warrants it. Such a report should not be lengthy, but should merely outline the significant facts regarding the company's business, its capitalization, earnings, financial position and dividend record. There should be a brief conclusion as to the general type of security, whether it is suitable for permanent investment, for temporary investment, or is speculative, to be held as a work-out or to be sold at once.

If the situation is more involved, or if the investment constitutes a large percentage of the trust fund, or if there are spe-

cial features to be analyzed, a thorough analysis should be prepared.

Ample copies of each of the forms are made up for distribution. The "fee-and-schedule" information is typed on one copy together with the principal and income, and cash balance on "under will," "under agreement," and "estate administration" accounts. The review and analysis are forwarded by the reviewer to the investment officer with a memorandum.

SUBMITTING REVIEWS AND ANALYSIS TO INVESTMENT COMMITTEES.—The review and analysis are scrutinized by the investment officer and an opinion formed as to what action, if any, should be taken with reference to the securities. The investment officer also has an additional sheet typed showing the provisions of the trust which are pertinent to an investment inquiry, such as the date established, the beneficiaries, the distribution, and the section of the instrument relating to investments. Copies of the sheets are sent to the members of the investment committees which meet weekly to consider the securities. The members of the investment committee look over the reviews and at the meeting discuss each account. From this discussion definite recommendations are formulated. Under the direction of the investment officer, these recommendations and comments with reference to the securities are typed on the sheets showing the provisions, which are then attached to the reviews and analyses. Copies of the reviews, analyses, provisions, and recommendations are sent to the members of the central investment committee for the classification of accounts involved. This committee meets weekly, discusses the recommendations of the investment committee, and makes the final decision as to the action to be taken on each account. Minutes of the meeting of each committee are taken by the secretary of the investment committees, and, under his direction, added to the proper sheets on which the recommendations have been placed.

After approval by the investment committees, a copy of the minutes, analyses, and reviews is placed in a permanent minute book. Other copies are sent to the investment officer and reviewer so that the course of action decided upon may be carried out. Copies are also sent to parties interested and put in the investment folder. A special copy goes to the administrative officer, who studies it carefully and makes what notations he deems necessary. When it is returned by him, parts containing significant information as to sales decided upon, etc., are put in the statistical file. Except on agency accounts, the last copy of the review and analysis is sent to the fee division for reference

to the administrative officer who sees that the proper fee is charged. From here, it is forwarded to the tax division to be used in computation of the personal property tax. When it is necessary to take certain steps immediately, prior to the preparation of the minutes, the investment officer makes a note of them during the committee meeting and instructs the reviewer. The reviewer reports to the investment officer as the work progresses, so that the latter may see whether instructions are being carried out promptly.

On agency accounts, the first copy of the review and analysis is sent to the customer, accompanied by a letter commenting upon the securities, and outlining the recommendations of the investment committees. This of course necessitates the use of other copies for the investment folder, etc.

INVESTMENT ANALYSIS.—When an analysis is desired, a requisition is sent to the manager of the trust investment division. He assigns to an analyst the duty of preparing the report.

The analyst first obtains from the investment division the statistical file with reference to the security. If the information given therein is sufficient for the purpose, it is referred to the one who requested it. If not, a report is prepared, the length and scope of which depend upon the nature of the inquiry.

In its survey of developments which may affect the securities in the accounts, the statistical section employs the various statistical services, financial manuals, corporation and government reports, periodicals, the trust investment department files of the company, economic and statistical information, and files of the credit department. In addition, individual officers who have special knowledge of particular situations may be consulted, or inquiries may be directed to other sources outside of the bank.

All analyses of securities of a statistical nature are made by a group of analysts, who are under the direction of a senior analyst. In addition to preparing reports requested by the investment committees, investment officers, or administrative officers, to aid in the review and administration of the various accounts, the analytical section at all times keeps in touch with the general market situation and the activity of business. When any particular industry or security is being affected by adverse factors, an investigation is made to determine what effect the situation has on the securities held by the trust department and a report is written on the matter.

There is a regular analysis of securities by types; for example, the general railroad situation is reviewed in so far as it affects railroad investments. The same procedure may be followed with

respect to all other types of industries. Analysis by classification will insure that factors affecting an industry will be considered in respect to all securities of a given class held by the trust department.

Where a security is held in a number of accounts, it is essential to have an analysis of such an investment. The same report is applicable to each account where the security appears. A careful analysis is periodically prepared on such securities. The frequency of the reviews, however, is determined by the grade of the investment.

When the report has been prepared, it is submitted to the senior analyst or to another analyst designated by him, for review. It is then sent to the party who requested it. If it is submitted to an investment committee, the security is discussed and a decision reached with reference to it. The decision is recorded in the minutes of the meeting, copies of which are sent to those who are to carry out the action determined upon. Copies of the report and the minutes pertaining thereto are put in the statistical files of the investment division.

When the security under analysis is held in but one classification of accounts, the report is sent to the investment officer concerned for submission to his investment committee or the central investment committee. However, should the security be held in more than one classification of accounts, the analysis is submitted to the general investment committee. When studies are made of industries or associated systems, they are discussed at a meeting of the general investment committee. In all cases sufficient copies of the report are made so that one can be given to each member of the committee concerned.

One of the duties of the analytical section is to maintain a list of securities approved for trust investments. A search is carried on at all times for security issues which are of sufficient merit to serve this purpose. When such a one is found, a report is submitted to an investment committee which decides whether it shall be added to the list. Constant attention is thereafter given to these securities to determine how they may be affected by subsequent developments. When any development of importance arises, a report is prepared for submission to the investment committees. Also, when a large amount of a certain issue has been purchased, it is taken off the list so that the institution may not be involved too heavily in one issue.

In addition to the analysis work discussed above, the statistical section maintains a rather complete history of economic, industrial and financial conditions to be used as a background for

investment analysis. This information covers general business conditions, production, trade and commerce, finance and credit conditions.

INVESTMENTS.—Investments for the various accounts are selected by the investment officer working with the administrative officer and the investment committees. The availability of funds for investment is brought to the investment officers' attention in a number of ways.

Whenever a new account is received in which there is cash to be invested, or whenever additional cash is deposited in an account, the administrative officer handling the account and the investment officer confer upon a plan of investment. The investment officer instructs the reviewer as to the securities to be purchased, and the latter prepares the proper tickets.

Each month the securities cage makes up a list of all securities held in the trust department which mature or have been called for redemption the following month. A copy of this list is sent to each investment officer who refers it to the reviewer. Plans are made for handling the funds from these maturing or called obligations. New investments are selected from the list approved for trust investments to fit the requirements of each particular account. After the selection is checked and approved by the investment officer with the advice of the administrative officer, the reviewer then writes letters to those who must be consulted, if any, suggesting reinvestment in the securities selected. A notation of such action is made on the list so that it will be taken into consideration when the funds are available.

In the case of agency accounts, the list of maturing and called items is forwarded to the reviewers for proper attention. If the bank has the sole responsibility of reinvestment, or has been requested to make suggestions, the investment officer is consulted. Upon his advice, securities are purchased, or letters are written under his direction for the signature of the officer handling the account. On the remaining accounts, advice is given by form letter.

The securities cage sends to the manager of the investment division each day a copy of the "securities-delivered" tickets. A part of these tickets is stamped, removed, and forwarded to the auditor as a notification of the receipt of the tickets. The tickets are then sorted according to classifications and sent to the reviewers handling them. The reviewers select those which represent a receipt of principal cash in the account, and forward the remainder to the file clerk who puts them into the investment folders. The reviewer then obtains the principal-and-income

cash balances and the investment folders for the tickets he has retained, and delivers them to the investment officer. A security is selected by the investment officer from the list approved for trust investments, to fit the requirements of each particular account, and is referred to the administrative officer for approval. The reviewer makes out "buy" tickets for each proposed purchase.

A trial balance is taken by the cash records division twice a month. This is sent to the manager of the trust investment division who distributes it among the reviewers assigned to the various accounts according to classifications. It is then checked to determine whether or not the principal cash balance is in the process of being invested, and if not, the situation is investigated and referred to the investment officer. At the same time the income balances are checked with a card file, maintained by the reviewer for each classification, showing the accounts in which a provision has been made for the accumulation and investment of a portion of the income. When funds of this nature are available, the selection of an investment is made as before described.

In connection with the checking of the trial balances, a list is prepared once a month of all net overdrafts, the various items being segregated according to the administrative officers to whom the accounts are assigned. The list indicates the reason for the overdraft, and an asterisk is shown for each time the item has appeared on the list after the first time. Copies of the list are sent to the proper officials.

BONDS AND OTHER SECURITIES FOR INVESTMENT.—A number of institutions have a policy of purchasing bonds and other securities for accounts in anticipation of trust investments. The individuals authorized to effect these purchases make arrangements with the security dealers and prepare "bought" tickets which describe the security and indicate the price and delivery date. These tickets must show the accounts for which the securities are being purchased. By the use of "sold" tickets the securities are later transferred to the account for which they were bought at the original purchase prices, plus accrued interest for the interim in which the security was retained in the trust investment account. A report on this account is prepared weekly by the order clerk and copies are sent to the proper committees, officers, and reviewers.

MORTGAGES AND NOTES FOR INVESTMENT.—All mortgages which come to the attention of the officer in charge of the real estate division, and are believed by him to be suitable for trust accounts, are referred to the real estate mortgage committee,

consisting of officers of the trust department. If approved for such purpose, they are purchased so that mortgages in sufficient amounts and denominations may be available when needed.

Before a loan is presented to the committee, the real estate division prepares an appraisal in quadruplicate and a "bought" ticket in duplicate which describes the mortgage and indicates from what source it is to be received. The first copy of the appraisal is sent to the committee, and if the loan is suitable, the appraisal is approved by the members of the committee and returned to the real estate division. A copy of the appraisal is sent to the secretary of the investment committees, stamped "approved" and incorporated in the minutes. The remaining copies of the appraisal and the "bought" tickets are retained by the real estate division. Notification is then given to the broker and the mortgage is acceptable. When the mortgage is presented, it is referred to the real estate division for examination of the papers. If they are in order, the original of the appraisal and the "bought" ticket are attached, the mortgage is turned over to the securities cage, and payment is made. The securities cage acts only when the appraisal is approved by the officer in charge of the investment division, by the officer in charge of the real estate division, and by one other officer of the trust department.

When it is desired to purchase a mortgage, the investment reviewer fills out a "buy" ticket, showing the name, classification, and number of the account, the amount of mortgages required, the interest rate and any restrictions as to size, due date, etc., concerning the requirements of the particular account. This is approved by the administrative officer or investment officer. A copy is given to the order clerk, who selects from his copies of the "securities-received" tickets, one covering a mortgage which will correspond to the request. If the entire amount of any individual mortgage is to be used, the "securities-received" ticket is attached to the "buy" ticket and sent to the securities cage, which puts through the necessary cash and securities tickets to transfer the mortgage from the trust department mortgage-and-note account to the trust account involved. The name of the account is noted on the appraisal, which is then sent to the investment reviewer to be put in the investment folder. If only a part of a loan is being purchased, the order clerk transcribes to the "buy" ticket the full description of the mortgage as shown on the "securities-received" ticket upon which a note is placed as to the amount used. A copy of the "buy" ticket is then sent to the securities cage where it functions as heretofore described. The "securities-received" ticket is replaced in the file. In these

instances a copy of the appraisal is made up and sent to the investment reviewer for the investment folder. A copy of the "buy" ticket, when received from the investment reviewer, is forwarded to the cash records division to show that the funds are in the process of being invested.

When it is desired that a mortgage be sold from a trust account, the investment reviewer first ascertains whether or not it was originally purchased through the real estate division. If it was, the appraisal is removed from the investment folder, or if an appraisal was not put in the folder, it is obtained from the real estate division and a copy made. The appraisal is sent to the officer in charge of the trust investment division with a memorandum, outlining the situation, signed by the administrative officer or investment officer. This is discussed with the proper officer of the real estate division and such of the other officers as seems advisable. A decision is reached as to whether it should be purchased for the trust department mortgages-and-notes account for investment, or for the bank-investment account, and in either event, as to the price to be paid. Notification of the decision is given to the investment reviewer and the appraisal is returned to the proper department. If a sale has been authorized, the investment reviewer prepares a "sold" ticket showing the name, classification, and number of the account, the amount and description of the mortgage, the price, and the account to which it is to be sold. A copy of the ticket is approved by the proper administrative officers and investment officials. The necessary steps are then taken to transfer the mortgage by means of the appropriate cash and securities entries.

If the mortgage was not purchased through the real estate division, a "sell" ticket is prepared in the usual way and is given immediately to the order clerk who, with the assistance of the investment reviewer, locates a market and executes the order. In such cases, a copy of the "sell" ticket is marked on the reverse side with the name of the broker, the sale date and price, together with the delivery date and place of delivery. The ticket is transmitted to the securities cage and upon its authority the mortgage is delivered and payment received. When mortgages are purchased into the mortgages-and-notes accounts for investment, the "securities-received" ticket, which is received from the securities cage, and the appraisal are placed by the order clerk in the file showing the mortgages held in this account.

If a mortgage is not paid at maturity, the real estate division handles all negotiations for the extension, renewal, carrying past due or foreclosing—whichever course in its judgment is desirable.

SPECIAL ITEMS—DIVIDENDS.—The dividend clerk is responsible for the correctness of dividend information on the addressograph plates. As dividend announcements appear in the daily sections of the financial services to which the trust company subscribes, they are checked against the holder's cards in the addressograph card file. If the information as set forth in the financial services coincides with that already shown on the addressograph plate, no change is necessary.

Whenever the dividend clerk is informed by the financial services that any particular company is declaring an extra cash dividend on securities held by the institution, a memorandum setting forth the amount of the dividend, the record date, and payment date is sent to the supervisor of the securities records cage, in order that the cash tickets and remittance maturity ticklers may be corrected.

All addressograph copies of securities tickets, originating in the securities cage or corporate cage and covering the deposit of stocks, are checked by one of the addressograph file clerks against the available dividend information contained in the current financial services. This file clerk also checks the holder's file to determine if there are any other holders of stock of the particular company under consideration. In this way, dividend information on all holders' cards of any particular company is kept uniform. If the information is found to be correct, the tickets are sent to the addressograph department and the addressograph plate is prepared. When the file clerk cannot find the necessary information in the current publications, the securities tickets are marked "no information" and the addressograph department runs special cards which are given to the dividend clerk for the purpose of follow-up on the dividends concerned. Thus no dividend item escapes attention.

The dividend clerk also checks the announcements of regular and extra stock dividends appearing in the daily sections of the financial services against the holders' file in the addressograph card file. When stock of a company declaring such a dividend is held, a list of the holders of this stock is prepared. After the cards for the securities tickets from the securities cage, or the corporate cage, representing work coinciding with the record date of the stock dividend, are placed in the addressograph card file, the list of holders is sent to the vault for the purpose of checking the number of shares held. This "list-of-holders" notice shows the rate and whether fractional shares are entitled to a dividend. When the person in charge of the vault has checked the list, copies are sent to the proper parties and divisions of the

trust institution. In the case of stock dividends, a copy is sent to the auditor, who checks to see that the stock is received.

The dividend clerk has a file of cards showing the names of the companies and the classes of stock for which the institution is acting as transfer agent. If the financial services indicate that any cash or stock dividends have been declared on these stocks, a memorandum is given to the stock transfer division.

A special procedure is set up for the handling of dividends payable at the option of the stockholder in stock or cash.

BOND AND STOCK CALLS.—The investment division has the responsibility of notifying the proper parties of all securities held by the trust department which have been called for payment.

When notices of call appear in called-bond information sections of the various financial services, or are received from some other authentic source, the information with respect to such call is transcribed to a proper form, "notice-of-called-bonds." This is done to service any securities which have been called.

When securities of a company issuing a call are on deposit, they are noted to the effect that the issue has been called. Then a list of holders is made up on the called bond notice. This form bears the name of the company issuing the call, the description of the issue, the place of payment, date called, price, and whether the entire issue is called or whether the call is by number; also the interest payment dates of the security under consideration. If there are any conversion or exchange privileges, these are also shown. When the call is by number, the procedure is slightly different.

Called bond notices are distributed to the proper parties and departments of the trust institution. In return the necessary acknowledgements are made.

When notice is received to the effect that a stock is called, a list of holders is then prepared showing the manner of registration of the stock certificate, and containing information as to whether or not such certificate is endorsed or has a blank stock power attached.

As a double check, to assure the accuracy with which the notices are handled, the called bond clerk removes all the holders' cards from the file of the issue which is called, three days prior to the called date, and inspects the cards to determine whether each is properly stamped to show that the issue was called. If any cards do not have this notation, it is assumed that they indicate additional deposits received since the original call notice was made and the proper parties are immediately notified to send these additional holdings out for collection.

PRIVILEGED SUBSCRIPTIONS.—The rights clerk checks the sections of the daily financial services covering rights to subscribe to additional stock. When this privilege is offered by any company the securities of which are held in any of the accounts in the trust department, the rights clerk prepares a special sheet giving full details of the offer. This sheet shows the name of the company, the record date of the stock entitled to such rights, the date on which the rights expire, and the basis on which such rights are issued.

This clerk also prepares a list of holders of the securities affected. This list is checked to verify the number of shares held and the manner of registration. A new list is then prepared giving this information, and copies of this list, together with a copy of the special sheet, are distributed to the proper parties and divisions of the trust institution.

The investment officer assigned to the agency group of accounts instructs his investment reviewer to write to all of the clients affected, giving full details of the offer and asking for instructions concerning the disposition of the rights. Stock powers are enclosed to be signed and returned if all, or a part, of the rights are to be sold. When informed of the central committee's decision through a copy of its minutes, the investment officer assigned to the other classes of accounts consults the administrative trust officers of the accounts affected, and after receiving their instruction, advise their investment reviewers with respect to the letters to be written to co-trustees and other interested parties. When it is necessary, stock powers are secured.

All letters of instruction are acknowledged by the investment officer or his investment reviewers. It is their duty to see that arrangements are made to have sufficient money on hand to cover subscription, and in the case of sale, to have a stock power to be used for transfer purposes.

Subscription tickets are made as soon as instructions are received. These tickets show the name, classification, account number, and the par value of bonds or number of shares upon which the subscription is being made. They also show a description of the security, subscription price, the date before which the subscription must be made, payment plan, and special instructions concerning payment, such as writing for funds, charging checking account or savings account. If part of the rights or other securities are to be sold to obtain funds, or if additional rights are to be purchased, this too is indicated.

Rights necessary to complete subscriptions are purchased as soon as such instructions are received. They are purchased on a

"when issued" basis if instructions are received before the rights are issued.

Sales are made on a "when issued" basis for agency accounts when instructed, and with the approval of the administrative trust officer to the other accounts, when the stock, upon which the rights are issued, is registered in the name of the nominee or the name of the bank as trustee, executor, etc. In those cases in which rights will not be "good delivery" the sales are made "subject to transfer." When the rights are sold on a "when issued" basis, a memorandum is sent by the investment reviewer to the vault to be attached to the stock certificates, to prevent the sale of stock before the record date.

The necessary copies of the subscription tickets, and of the "buy" and "sell" tickets are delivered to the securities cage. A duplicate copy of all subscription tickets, stating that funds are to be taken from checking and/or savings accounts, is transmitted by the securities cage to the cash records division when the subscription is entered.

When handling transactions involving the sale of enough rights to subscribe for the balance, the securities cage is notified by a memorandum to have the subscription warrants split, so that delivery can be made of the rights sold and the balance used for subscription. Sale orders are then entered "subject to transfer."

When instructions have been received to enter subscriptions on a partial payment plan, which is not an uncommon practice, it is the duty of the investment reviewer making the subscription ticket to make a tickler card for the securities cage to notify it of future payments.

Bond Delinquencies and Reorganizations.—Memoranda regarding bonds or coupons sent out for collection and returned unpaid—except those held in safekeeping accounts—are given by the collection cage to the investment division and the administrative officer handling the accounts involved. The memoranda to the investment division are examined by the reorganization analyst, and if information regarding the default is not available he makes inquiries regarding the situation.

In about two weeks time, if the collection cage does not advise receipt of payment, a delinquent notice is set up. In some cases interest payments are continued although the principal is unpaid. In this case the notice is marked "principal delinquent, interest being paid."

The memoranda to the administrative officer are referred to the investment officers. If agency accounts are involved, the

investment reviewers are instructed to inform the clients. This is also done on other accounts where required.

The collection cage institutes an inquiry as to whether or not the coupons or bonds will be paid in a short time. If payment is received, a memorandum is transmitted by the collection cage through the reorganization analyst to have the delinquent notice removed. When it has been determined that payment will be delayed, or that a protective committee has been formed, all information and correspondence is turned over to the reorganization analyst, who follows up the situation from that point. This applies to all securities except real estate loans or farm loans, which are referred to the real estate division. The reorganization analyst also obtains information as to the formation of protective committees from services and letters received from clients and securities dealers.

In investigating an issue, the reorganization analyst communicates with various sources of information to determine what steps are being taken to cure the default. As soon as the information is obtained, a report is prepared showing the holders, the reason for the default, and a summary of the situation. A tickler card is established for each security and if periodical reports are not received, further inquiries are made.

If notice is received that funds are available to pay delinquent items, or to pay liquidating dividends upon them, the collection cage is notified. When a definite plan of procedure, as evidenced by a deposit agreement or a plan of reorganization, is formulated, this is analyzed and submitted, with a recommendation as to the course to be followed, to the investment committee which considers securities in general. If only one classification of accounts is involved, it is referred to the committee for that class. A decision is made with respect to the situation, and a copy of the minutes is sent to each investment officer, who instructs the investment clerks as to the action to be taken. On items held in agency accounts only, information is given to the investment officer, who requests the investment reviewer to write to the clients, outlining the situation and requesting instructions. In any case in which the securities are to be deposited or exchanged, the investment reviewer prepares a memorandum which is signed by the administrative officer and sent to the securities cage.

The auditor sends all vault coupon cutting tickets covering items upon which payment has not been received, and which are not otherwise accounted for, to the reorganization analyst. These are checked against his records to indicate that the items are receiving attention, and returned to the auditor.

PURCHASES AND SALES.—Purchases and sales of securities for agency or corporate accounts, are made at the direction of the customers, except where the bank has been given control over investments. In the other classification of accounts, the orders usually originate with the investment committees and the administrative officers. There are, however, instances in which the grantor of the trust retains certain control and gives instructions as to the securities, or other accounts in which the co-trustee must be consulted.

Information as to each transaction is conveyed to the investment reviewer handling the account, who prepares the proper ticket by means of which the purchase or sale is carried out. This ticket is approved by the administrative officer or the investment officer to whom the account is assigned, or, if a memorandum initialed by one of these is sent to the investment division giving the details, by the supervisor, or an authorized senior clerk of that division.

Here in brief is a sort of cross-section of the work of the trust department. In the discussion above there has been no intention to favor any one type of procedure over another, but an attempt has been made to present a composite picture of the procedure used in several large trust institutions. The picture presented, incidentally, is far more complete than the actual material found in most trust institutions would warrant. It is not intended to give the impression that only trust institutions with elaborate organizations are qualified to do investment work, for much less elaborate methods than those described permit good investment service. The quality of service is not measured by the elaborateness of the method. However, many trust institutions are inadequately prepared to give proper investment service. The paucity of proper records and the haphazard procedure are frequently ample testimony to this statement.

Chapter III

COMMINGLED TRUST FUNDS—AN ENDEAVOR TO FACILITATE TRUST INSTITUTION INVESTING

PROBLEMS OF TRUSTEE INVESTING.—Commingled trust funds have been established in an endeavor to solve some of the problems of property and investment management. A number of these problems are due primarily to the following factors: First, there has been an enormous growth in the personal trust business of trust institutions; second, the number of individual trust accounts has greatly increased; and third, the demand for trust service by individuals of small means has increased.

SIZE OF CORPORATE PERSONAL TRUST BUSINESS.—The aggregate of personal trust property handled by trust institutions totals many billions of dollars. New York has over ten billion; the total for Pennsylvania exceeds five billion; Illinois trust institutions administer over five billion; while Massachusetts has about a billion dollars of trust assets. Although specific data are not available for most states, many of them have large quantities of personal trust property which are handled by trust institutions. Dozens of individual trust institutions throughout the United States handle personal trust property aggregating $100,000,000 to over $1,000,000,000.

NUMBER OF ACCOUNTS SUPERVISED.—The number of individual trust accounts being administered by trust institutions in the United States is not known, but the aggregate is large. The total number being administered by national banks is more than 100,000.[1] The various types of trusts in Illinois represent a total of 87,945 accounts.[2] Scores of trust institutions handle various types of trusts ranging from a small number to over ten thousand accounts.

SIZE OF TRUSTS.—The individual trusts handled by national banks as of June 30, 1931, averaged only $49,319.[3] For all accounts administered by trust institutions in Illinois the average is approximately $57,000. In the examination of hundreds of accounts in five states the author found that small trusts of

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[1] *Report of the Comptroller of the Currency,* 1933.
[2] *Trust Companies,* Vol. 56 (March 1933), p. 394.
[3] *Report of the Comptroller of the Currency,* 1932.

$25,000 or less occurred most frequently. That small trusts are most numerous is explained by two facts. First, there are relatively few large trusts to be obtained because of the manner in which our wealth is distributed. Second, some wills create a number of separate trusts.[4] According to a study by the Federal Trade Commission[5] of 43,512 estates probated in selected counties of the United States, 1912–1923, 90.2 per cent were of less than $25,000 and in the aggregate constituted 26.2 per cent of the total amount of property probated. An estimate of the distribution of capital among property owners in the continental United States, as of December 31, 1921,[6] showed that 95.7 per cent of the property owners, or over 39,000,000 people, owned less than $25,000 per person. This group of property owners owns in the aggregate 49.4 per cent of the total capital of the United States.

TRUST ASSETS OF TRUST INSTITUTIONS CONTINUE TO GROW.—That the problems of property and investment management by trust institutions will not become less serious is based upon the belief that the amount of personal trust business handled by trust institutions will continue to increase. While there are no figures for the growth in the personal trust business handled by all trust institutions during the past few years, there are data from certain financial areas and for the national banks which are significant. During 1931, the trust institutions of Philadelphia showed a substantial gain in personal trust property over 1930; six of the leading trust institutions of that city reported a total increase of approximately $200,000,000, ranging from a gain of $2,000,000 to $86,000,000 for individual companies.[7] The gain in 1932 over 1931 by these same institutions amounted to approximately $170,-000,000 varying from an increase of $2,000,000 to $75,000,000 for each institution.[8] There was an increase of $230,000,000 for all trust institutions in Pennsylvania for 1932.[9]

Since the close of 1928, the Old Colony Trust Company of Boston increased its assets from $280,589,000 to $392,400,000 at the close of 1932. In 1932, the increase was $14,000,000. The Boston Safe Deposit and Trust Company grew from $153,005,000

[4] The author has seen as many as forty different trusts established by a single will.

[5] *National Wealth and Income,* 69th Cong. 1st Sess., Sen. Doc. No. 126, p. 58.

[6] King, W. I., "Wealth Distribution in the United States," *Journal of the American Statistical Association,* Vol. 22 (June, 1927), pp. 135-153.

[7] *Trust Companies,* Vol. 54 (Jan. 1932), p. 131.

[8] *Trust Companies,* Vol. 56 (Feb. 1933), p. 271.

[9] *Trust Companies,* Vol. 56 (March 1933), p. 389.

in 1928 to $246,730,000 in 1932. It showed an increase of $27,-000,000 during 1932. Other trust institutions in Massachusetts also showed substantial gains in these periods.[10]

Trust institutions in Illinois showed a net increase of trust business for 1931 and 1932 of $158,000,000.[11]

For the year ending June 30, 1930, the number of individual trusts administered by national banks showed a 20 per cent increase, and total personal trust assets increased 5.5 per cent. The figures for the fiscal year 1931, showed a 15.8 per cent increase in the number of individual trusts and a 17.2 per cent increase in total trust assets. In 1932 there was an increase in the number of individual trusts but a decrease in trust assets. There was a substantial gain in the personal trust business of national banks for 1933, both in the number of individual trusts and their aggregate value.[12]

THE RULE OF KEEPING INVESTMENTS SEPARATE.—Until recent years trust institution administration followed the practice customary throughout their history. The rule has been that the investments of individual trusts should be kept separate and distinct. "Trustees ought not to mix trust money with other moneys,—for this would be to complicate the trust with the rights of strangers;—Trustees should not ordinarily mingle funds of different trusts in one investment, even though the different trusts were established by the same will."[13] This has been the common law rule for ages, and it has been confirmed by statute in most states.

THE SMALL TRUST PROBLEM.—The investment and supervision of large sums of personal trust funds which are represented by separate and distinct accounts is exceedingly difficult under the theory that individual trusts must be kept separate, without commingling of assets. This is especially true with respect to small and medium-sized accounts. There are inherent problems in the administration of small trust funds.[14] A small trust cannot possibly be given the benefit of spreading the risk over many investments comparable to a large estate.[15] Further, small trusts are generally unprofitable. Practically the same records, supervision and reviews are required for a trust of

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[10] *Trust Companies,* Vol. 56 (March 1933), pp. 391-2.

[11] *Ibid.,* p. 394.

[12] *Reports of the Comptroller of the Currency; supra,* Table II.

[13] *Perry on Trusts,* 7th ed. (1929), Sec. 463.

[14] Perkins, James H., "Broadening the Scope of Trust Protection," *Trust Companies,* Vol. 51 (Oct. 1930), p. 429.

[15] Barclay, George C., "Co-Mingled Funds for Efficient Investment," *Proceedings Ninth Regional Trust Conference,* Oct. 1931, p. 51.

$15,000 as for one of $150,000, while there is a wide differential in fees. Although small trusts make their contribution to overhead costs, a disproportionately large number of such accounts increases overhead expenses faster than this contribution.[16] Because of these conditions it is frequently asserted that small trusts do not receive the careful investment attention they should, or that they are conservatively invested in mortgages, government bonds, or other high grade bonds which yield a comparatively low rate of interest.[17] Consequently it is the beneficiaries of small trusts who do not receive the full benefits of trust institution investment management.[18]

RISE OF THE COMMINGLED FUND IDEA.—In an attempt to find a solution to the small trust problem as well as to a number of other complicated problems of modern trust institution investing, the idea of the commingled fund came into being.[19] In addition to the problems enumerated above, three developments of the past few years have served to foster this idea:[20] the increasing contact between banks and life insurance companies, the bull market, and the rise of the investment trust. Through the life insurance trust, the banker has learned the advantages of the pooling of investment funds; the bull market served to familiarize the public with listed securities of all types—it gave trust customers, whose horizon had been confined to mortgages and local securities, new conceptions of the scope of investment authority possible in trust agreements; while the investment trust made possible the purchase of a wide range of securities never before made available to the average small investor.

BRIEF HISTORY.—Although the commingled plan is only a few years old, there seems to be a nation-wide interest in the matter and it is fast growing in popularity among leading banks and trust companies.[21] To the writer's knowledge, the first mingled fund was evolved in March, 1929.[22] In 1931 there were

[16] Clifford, Edward L., "Commingled Trust Funds," *Harvard Business Review*, Vol. 11 (Jan. 1933), p. 253.

[17] Perkins, *op. cit.*

[18] Barclay, *op. cit.*; Clifford, *op. cit.*; Perkins, *op. cit.* These are the theoretical arguments in the case; but no data are given on these points.

[19] See Smith, James G., *Trust Companies in the United States*, (1928), Ch. 17; Smith, Maclin, F., "Commingled Trust Funds as a New Advance in Fiduciary Service," *Trust Companies*, Vol. 54 (May 1932), p. 593.

[20] McWhinney, Leroy, "Extending to Trusts the Principle of Mingled Investments," *Proceedings Twelfth Mid-Winter Trust Conference*, Feb. 1931, p. 104; Hutchens, H. King, "The Uniform Trust Plan," *Proceedings Eighth Regional Trust Conference*, Aug. 1930, p. 77.

[21] McWhinney, *op. cit.*

[22] This was the City Bank Farmers Trust Company's Uniform Trust Plan "A." Apparently it was not intended for trust estates.

approximately fourteen such funds in operation by seven different institutions.[23] The principal trust companies actually operating commingled funds are the Equitable Trust Company of Wilmington, Delaware; in New York, the City Bank Farmers Trust Company, the Irving Trust Company, the Guaranty Trust Company, and the Brooklyn Trust Company; in Boston, the Old Colony Trust Company; in St. Paul, the First Trust Company; and in California, the Bank of America. Somewhat similar commingled funds, confined solely to mortgages, are in operation in a number of states—Pennsylvania, Ohio, Michigan, Oklahoma and probably others. In addition, there are many related plans for prorating participation in individual mortgages, a highly efficient arrangement now authorized by law in some states.[24]

COMMINGLED TRUST FUND PLAN.—The fundamental principles of commingling are simple. Under such a plan the funds of various individual trusts are transferred to a common fund which is invested and administered as a unit.[25] The fund has no separate legal status but each participating trust immediately owns a share in each of the different securities in which the fund is invested. "The trustee is given full discretion with regard to the investment of the trust property and is further authorized, in its judgment, to mingle the trust property with the funds of other trusts."[26] In general, commingling is modelled on the same principles as those whereby the reserves of insurance companies are placed in a joint fund. The assets of this fund "are invested in a wide variety of securities in which each participating trust has an exact proportionate interest."[27]

Participation in the mingled fund may be represented through stock ownership, or by some form of certificate of beneficial interest, or by bookkeeping entries alone which furnish the evidence of such participation.[28] The certificates of participation are non-negotiable and non-assignable except to the trust institution as trustee.[29]

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[23] Barclay, *op. cit.*

[24] See Knowles, Ralph W., "Pooling of Mortgages for Trust Investments," *Trust Companies,* Vol. 46 (May 1928), p. 631; Wilson, Wm. A., "Advantages and Disadvantages of Mortgage Pool for Trust Investments," *Trust Companies,* Vol. 54 (June 1932), p. 705; McWhinney, *op. cit.;* "Investment for Trust Funds—Is Real Estate Mortgage Pool Plan Correct in Principle?," *United States Investor,* June 29, 1929, p. 1.

[25] McWhinney, *op. cit.;* Smith, Maclin F., *op. cit.;* Clifford, *op cit.*

[26] Perkins, *op. cit.,* in discussing the Plan of Uniform Trusts of City Bank Farmers Trust Company.

[27] Barclay, *op. cit.*

[28] Clifford, *op. cit.;* Barclay, *op. cit.,* p. 57; Smith, Maclin F., *op. cit.*

[29] *Ibid.*

The legal status of each participating trust in the composite fund is kept separate from that of all the others. "There is no mingling of trusts, but rather of the assets of the trusts, and these are united for investment only. . . . The individual trust retains its own identity just as do individuals participating in an investment pool."[30]

Units are assigned to each participant based on the value of the fund on the day of the mingling.[31] Books are kept to show the exact proportionate interest of each trust in each security of the fund. Generally definite valuation dates are set at which time the entire fund is valued. On these dates new participations or withdrawals are made. These additions or withdrawals are made at the unit value as of that date. The unit value is derived by dividing the total value of the fund by the total number of outstanding units.[32]

Adequate records are also kept to reflect the income and profits of each trust. Distributable income is calculated by figuring all interest and income payable in definite fixed amounts on an accrual basis. The period of calculation is the time since the last valuation date. All other income is calculated on the basis of actual receipt. From the total income is deducted the cost of operating the fund plus any necessary adjustments in interest or other income. Each trust is then credited with its share of the net income, which is determined according to the ratio of units in each trust to the total number of units of participation in the fund.[33]

TYPES OF COMMINGLED FUNDS.—There are two broad general classes of commingled funds. The first general class of composite funds was devised for a large group of investors who realized the difficulties of inaugurating and carrying on an investment program of their own. In general, this group consists of those who are distrustful of their own judgment or who lack the time necessary for this work. Consequently the trust institution is being called upon to an increasing degree to act as agent or investment manager. "In other words, trust companies are in many cases receiving fees, not so much as trustee, but as investment analyst or counselor.[34]

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[30] Barclay, *op. cit.*, p. 51.

[31] This principle is followed in the Uniform Trusts of City Bank Farmers Trust Company.

[32] Barclay, *op. cit.;* Smith, Maclin F., *op. cit.;* Perkins, *op. cit.;* Hutchens, *op. cit.*

[33] Smith, Maclin F., *op. cit.;* Perkins, *op. cit.;* Hutchens, *op. cit.*

[34] Ward, Rodman, "Appeal for New Trust Business in Operation of the Co-Mingled Fund," *Trust Companies,* Vol. 55 (Sept. 1932), p. 291.

To serve this type of business a general class of mingled funds was devised which "is intended for the management under trust company supervision of the property of individuals during their lives, usually through a fully revocable separate trust instrument or participation in a large trust fund."[35] This general class of mingled funds comprises the City Bank Farmers Trust Company's plans of Uniform Trust A and B, Irving Investors Management Funds A and B, Brooklyn Trust Company's Composite Fund, the Old Colony Trust Company's Agency Fund and the Equitable Trust Company's Fund A.[36]

A second general class of mingled funds has been created in which the normal type of trusts, namely, testamentary, living, and life insurance, may participate. "Funds of this nature are Fund A of the Equitable Trust Company of Wilmington, Delaware, The Guaranty Trust Company of New York Fiduciary Fund Corporation and the City Bank Farmers Trust Company's City Farmers Fund (C), Inc., all of which contemplate a general investment policy; Fund B of the Equitable Trust Company of Wilmington, which is limited to legals; the new Trust Plan A of the First Trust Company of St. Paul, which is confined to bonds, though not necessarily legals; and the Irving Investors Fund C, Inc., and the Old Colony Trust Company of Boston's Stock Fund, both of which are limited to common stocks."[37]

Various forms of commingled funds exist which may differ widely according to the investment policy of each particular fund or to the local legal situation in each state. While no two are identical, they all have similar characteristics and operate under one of the following methods.

THE INVESTMENT TRUST PLAN.—The straight investment trust plan is adapted for use by living persons who may turn over cash to a trust company for investment, and permit the trustee to mingle their funds with the funds of other similar trusts.[38] This plan "may be accomplished by investing the fund in the shares of ordinary investment trusts, or by patronizing a centrally held investment trust designed particularly for the use of fiduciaries," or it may be effected "through an investment trust operated by the trust company for the use of its own trusts."[39] Such a plan may enable one to gain the advantages of trust

[35] Barclay, George C., "Valuable Experience with Commingled Funds for Trust Estates," *Trust Companies*, Vol. 56 (Feb. 1933), p. 183.

[36] *Ibid.*

[37] *Ibid.*

[38] Peter, Julius C., "Co-Mingled Trust Funds—An Analysis." *Proceedings Seventh Mid-Continent Trust Conference*, Sept. 1931, p. 36.

[39] McWhinney, *op. cit.*

company investment management. However, it is merely an investment counselor scheme and "is not suited for use by estates, and does not solve the problem of how to mingle funds belonging to testamentary trusts."[40]

THE POOL PLAN.—This is a plan whereby there is a pooling of trust assets. The mingled fund is managed by a common trustee for all the participating trusts alike. By this arrangement, a trustee, named by different instruments, may handle as a group the funds of many trusts no matter how they may have been created. The plan operates under the theory that each trust participating immediately owns outright a proportional interest in each security in which the fund is invested. The participating trusts receive as evidence of ownership a certificate of beneficial interest, or the interests of the various trusts are properly set forth on the books of the trustee. According to these representations each trust is entitled to its proportion of all income, profits, and losses.[41]

Since the trustee must follow directions in the instrument, trusts participating in the pool must be substantially uniform to permit such mingling of their funds with any degree of success. The difficulty may be met to a considerable extent by trust companies establishing several different types of funds.

In the operation of this plan there are many complicated accounting problems in connection with periodic valuations, income calculations, new participations, withdrawals, income tax calculations, etc.[42]

THE UNIFORM TRUST PLAN.—Under this plan an individual may create, with a trust company as trustee, a revocable living trust which provides that the trustee may, in its discretion, mingle his funds with any other similar trust and that the trustee is given full discretion with regard to the investment of the trust property.[43] Participation in the plan is limited to trusts created particularly for this fund which have uniform administration provisions.[44] The fund in this case is of no legal significance in itself. "It is the aggregate of the assets of many different trusts, created under instruments which, though identical in form, are entirely independent of each other."[45] "Under this plan the

[40] Peter, *op. cit.*

[41] For a discussion of The Pool Plan see Peter, *op. cit.;* Smith, Maclin F., *op. cit.;* Ward, *op. cit.*, p. 289.

[42] Smith, *op. cit.;* Peter, *op. cit.;* Ward, *op. cit.;* Clifford, *op. cit.*, pp. 258-9.

[43] Perkins, *op. cit.;* Hutchens, *op. cit.*, p. 77.

[44] Ward, *op. cit.*

[45] Barclay, George C., "Valuable Experience with Commingled Funds for Trust Estates," *Trust Companies*, Vol. 56 (Feb. 1933), p. 185.

common trustee executes a declaration of trust under which it declares that it holds the general fund in trust for the pro rata benefit of the various participants."[46]

"When the funds of a new uniform trust are added to the mingled fund, this new trust in effect purchases a participating interest in all the securities then held in the mingled fund and each trust already in the mingled fund sells a proportion of its interest in each security to the incoming trust. The cost to each trust of its participating interest in the securities is determined by the value of the securities at the time the trust is added to the mingled fund so that when a later trust is added all the trusts already interested in the mingled fund realize a profit or loss upon the participating interests then sold.

"A converse situation arises when a trust is withdrawn from the mingled fund, for at that time each trust remaining in the fund purchases from the outgoing trust a participation in the latter's interest in all the securities. Accurate records have been developed to reflect the income and profits of the uniform trusts in accordance with the above principles."[47] The complicated accounting problems met with in The Pool Plan are also involved in the uniform trust plan.[48]

The Corporate Plan.—Under this plan the trust company forms a corporation; the commingled funds are incorporated as a separate legal entity.[49] The securities of the corporation can be owned only by the trust institution when it is acting in a trust capacity.[50] Accordingly the corporation "sells shares of stock or units of a share of stock and an income bond to itself in its fiduciary capacity."[51] Trusts participating in this plan must grant not only broad investment powers but are required to have a clause specifically stating that the trust company has authority to invest in this fund.[52] The participating trusts are in reality stockholders in the incorporated fund.[53] Under this plan investment in commingled funds is similar to the holding of securities of a business corporation.

"In a corporation, it is the entity which makes all sales and

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[46] Smith, Maclin F., *op. cit.*, p. 595. He doubts that this serves any real purpose as common trustee is limited to powers granted in the trust instrument.

[47] Perkins, *op. cit.*, p. 430; Smith, Maclin F., *op. cit.*

[48] Clifford, *op. cit.;* Smith, Maclin F., *op. cit.;* Ward, *op. cit.*

[49] Smith, Maclin F., *op. cit.*, p. 596.

[50] Perkins, *op cit.*, p. 431.

[51] Ward, *op. cit.*, p. 289.

[52] Barclay, George C., "Commingled Funds for Efficient Investment," *Proceedings Ninth Regional Trust Conference,* Oct. 1931, p. 55.

[53] Smith, Maclin F., *op. cit.*

purchases, takes all profits and losses, pays all expenses, etc. Its books are kept like those of any corporation.[54] It is a most satisfactory method of handling the complicated mechanical and accounting problems of commingled funds.[55]

Under the corporate form, reserves for contingencies or against future depreciation in the principal value of the fund are set up without the usual complications, such as the rights of the life tenant or remainderman or without violation of the statutes against perpetuities and restrictions on alienation and without violation of the statute of accumulations.[56]

A COMMINGLED FUND PLAN IS SUGGESTED FOR INSURANCE TRUSTS.—A particularly interesting phase of the commingling idea is the novel suggestion that trust companies, interested in insurance trusts, "have authority conferred upon them by insurance trust agreements, under which they act, to deposit the proceeds of the insurance in a commingled fund to be invested by all of such trust companies jointly."[57] This method has been suggested to meet the criticisms directed against the current methods of handling funds under the insurance trust. Under the ordinary insurance trust, the trustee collects the proceeds of the insurance, and invests in specific securities, held for the particular trust and dissociated from the investments belonging to the other estates. Consequently the suspension of interest, or depreciation of principal, falls on the particular trust. Under the new procedure, "any loss of income by reason of the suspension of payment of interest on a security held in the fund, or any loss on the sale of a security is borne by all the persons interested in the commingled fund." Through the selection of the highest grade securities covering a wide field, the possibility of loss is minimized and a greater degree of diversification is obtained.[58]

ADVANTAGES OF COMMINGLED FUND PLAN—DIVERSIFICATION AND SOUND MANAGEMENT FEATURE.—Under the constantly changing conditions of the present day, the commingling plan is especially significant. Successful trust management today requires constant vigilance and keen attention to economic

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[54] Barclay, George C., "Valuable Experience with Commingled Funds for Trust Estates," *Trust Companies,* Vol. 56 (Feb. 1933), p. 185.

[55] Smith, Maclin F., *op. cit.;* Clifford, *op. cit.;* Peters, *op. cit.;* Barclay, *supra,* n. 54.

[56] Peter, *op. cit.*

[57] White, Joseph W., "Insurance Trust Organization," *Proceedings Thirteenth Mid-Winter Trust Conference,* Feb. 1932, pp. 91-8. A full discussion of the plan is given in this paper.

[58] *Ibid.*

developments that affect each security. It is no longer possible to buy a group of bonds, put them away in a vault, and forget them for long periods. They should be sold and the proceeds invested in other securities which can be purchased on a basis closer to their real value as indicated by the trend of business, money rates, etc. Such a policy the commingled plan attempts to put into effect, and through its ability to choose from a wide field it may offer a well-diversified investment policy. The composite fund may have in its portfolio, at the same time, for example, mortgages, some long and short term bonds, and preferred and common stocks, the emphasis upon each group shifting as the occasion demands. Not only may the fund be diversified among different types of securities but among different industries and among different companies in the same industry. As the securities fluctuate in value the worth of the trusts also fluctuates, but in the commingled fund each trust will have such a minor ownership that a loss in any single one will be negligible. In a period of severe decline in securities, when even the highest grade bonds may be weakened, it is inevitable that the whole portfolio will depreciate somewhat. Yet, this is far better than the loss resulting to individual trusts which are invested in a relatively few securities or are less well supervised. Such principles cannot be applied to small individual trusts; but through a composite fund, where the risk is widely spread, it is possible to give the smallest trust the advantages of diversification and full supervision.[59]

PLAN IS APPLICABLE TO ANY INVESTMENT POLICY.—The commingled fund idea is highly flexible so that it may be adapted to any investment policy. If conditions in one community differ from those in some other area whereby a different policy is required a type of mingled fund may be set up to fit the circumstances. Again, if there are differences of opinion as to investment policy among different institutions a mingled fund plan can be chosen which is adaptable to the particular requirements. As illustrative of these points we have at the present time some seven or eight institutions using at least fourteen different types of commingled funds. There are wide differences in both the form and purpose of these funds. Some funds are intended to be suitable as investment management trusts and estate building

[59] Barclay, George C., "Valuable Experience with Commingled Funds for Trust Estates," *Trust Companies*, Vol. 56 (Feb. 1933), p. 184; Barclay, George C., "Comingled Funds for Efficient Investment," *Proceedings Ninth Regional Trust Conference*, Oct. 1931, p. 52; Ward, *op. cit.*; Hutchens, *op. cit.*; Perkins, *op. cit.*; Smith, Maclin F., *op. cit.*; Clifford, *op. cit.*; Peter, *op. cit.*

trusts. Others are designed to be participated in by the normal type of trusts. The funds in some cases are restricted to common stocks; others are limited entirely to legals; while still others permit the widest variety of investments in the sound discretion of the trustee. There have also been developed different types of commingled fund plans to meet certain legal and technical difficulties as well as investment problems.[60]

INCREASED FACILITY AND EFFICIENCY IN REVIEWING ACCOUNTS.—Under the commingled fund the number of accounts to be reviewed would be reduced. It is an exceedingly difficult task to give proper attention to and make frequent reviews of several thousand or even a few hundred accounts. Certainly in the administration of a composite of many trusts the investment work would be more substantial. Further, there are some compulsory factors in the case. The additions or withdrawals of funds coupled with the necessity for valuing the composite account at certain times requires that attention be given the investments. Not only would there be fewer accounts to supervise but probably a commingled fund would require fewer different securities than the aggregate listed for all the individual accounts. Thus there would be fewer securities and corporations to follow through changing conditions and business developments. If review work is facilitated by the mingled fund an additional advantage arises in that the trusts not participating may also be reviewed more frequently.[61]

REQUIRES CHANGE IN INVESTMENTS RECEIVED FROM TESTATOR.—When trusts are established trustees are usually given the right to retain the investments received in trust. Under these conditions there is considerable temptation to hold the original investments rather than sell and face the involved economic and legal problems to be met in making the change. But when the power is given to commingle, the trustee is authorized to make the change as is expedient, in order to invest in the commingled fund.[62]

ELIMINATES DISCRIMINATION. — Frequently discrimination arises when a security is held in many different trusts and is sold out of these accounts at different times, or in a fluctuating market, or specifically out of each trust. Under these conditions it is most difficult to prevent better prices accruing to one trust than to another. Even alphabetical or mechanical position in the records may bring about a price differential. If market condi-

[60] *Ibid.*
[61] *Ibid.*
[62] Clifford, *op. cit.*

tions are such that only a proportion of the security may be disposed of the situation again arises. The problem is apt to arise where there are co-trustees, for consent cannot be secured with the same promptness from each one. A commingled fund avoids these discriminations.[63]

SURMOUNTS CO-TRUSTEE PROBLEM.—Various problems arise where different accounts are administered by both a trust institution and one or more co-trustees. In practically all matters no action can be taken without the consent of each trustee. Thus if a co-trustee is away or dilatory the trust institution is delayed or prevented from action, regardless of the situation or the consequences to the beneficiaries. In the case of the commingled fund, however, as they are commonly set up, once the co-trustee consents to the investment in the mingled fund the trust institution has full control of the investments.[64]

OTHER ADVANTAGES.—Additional advantages frequently stressed are the following: prompt investment of odd amounts at a fair rate of interest; ease in liquidation of small investments of the individual trusts; reduction of expense of handling small trusts; minimizing of administrative work; saving in expense to the trust company; the development of a more uniform trust portfolio.[65]

PROBLEMS AND DIFFICULTIES OF COMMINGLING—ESTABLISHING A COMMINGLED FUND.—The inauguration of a commingled fund is beset with many problems. Such a plan is not adaptable to all trusts; there will always be many trusts which should be administered individually. It is neither possible nor desirable to make all trusts conform to a uniform investment plan. Further, many creators of trusts do not favor any commingled fund plan; others prefer to retain at least some control over the investments. Thus, they object to the plan on the ground that it requires giving up all investment powers to the trust institution. Since the commingled plan appears to resemble an investment trust, many people refuse to sanction its use for the investment of their funds. In some cases beneficiaries do not favor the trust holding an undivided interest with others; they prefer to have the investments owned outright.[66]

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[63] Barclay, George C., "Co-Mingled Funds for Efficient Investment," *Proceedings Ninth Regional Trust Conference,* Oct. 1931, p. 52.

[64] *Ibid.* Some trust officials hold that the commingled trust cannot be used in co-trusteeship accounts.

[65] McWhinney, *op. cit.,* p. 107.

[66] McWhinney, *op. cit.;* Barclay, George C., "Co-Mingled Funds for Efficient Investment," *Proceedings Ninth Regional Trust Conference,* Oct. 1931, p. 52; Smith, Maclin F., *op. cit.;* Ward, *op. cit.*

FORMULATING AN INVESTMENT POLICY.—In operating the plan the problem immediately arises as to a suitable investment policy for all the participating trusts. Certainly no uniform policy can be followed because under existing conditions no two trusts participating in the fund are wholly identical. However, since very few trust institutions attempt to administer a commingled fund unless specific and express authority to do so is contained in the instruments creating the various participating trusts, this question may not be highly significant. The participant must recognize this situation if he understands the nature of such a trust. Even so, there are still vast differences among the participating trusts regarding the needs, requirements, and position of the beneficiaries. Hence, the problem arises of formulating an investment policy that will be adequate for all trusts.[67]

NOT ADAPTABLE TO ALL EXISTING TRUSTS.—A commingled fund plan is not suitable for a considerable proportion of existing trusts. The majority of these trusts do not authorize the commingling of their funds. Without such authorization it is impracticable or even dangerous for a trustee to mingle funds for investment purposes. The commingled fund should only be used for trusts which have granted this power to the trustee or which may hereafter grant such authority by amendment of the trust agreement.[68]

Due to the differences in investment powers granted by various trust instruments it would be impossible for a trust institution to combine all of its trusts into a commingled fund. For example, if the instrument specified investment in bonds of a certain type, or other specifically designated security, such trust funds could not be mingled if the composite unit contained any investment outside the list. Trusts which designate stock dividends or subscription rights as capital cannot be mingled with those which treat them as income. These and many other provisions commonly found in trust instruments are typical bases for differentiation, thus making it impracticable to apply the plan to a majority of those trusts already in existence. But as a practical matter, the volume of assets involved in trusts containing similar broad authority to invest in bonds, mortgages, and other proper investments is ample for the operation of a mingled fund, provided express authorization is given the trustee to mingle these funds.[69]

NEW PARTICIPATIONS, WITHDRAWALS AND REDEMPTIONS.—The smooth operation of the unincorporated commingeld fund

[67] McWhinney, *op. cit.;* Clifford, *op. cit.;* Peter, *op. cit.*
[68] Smith, Maclin F., *op. cit ;* Peter, *op. cit.;* Clifford, *op. cit.*
[69] Peter, *op. cit.;* Clifford, *op. cit.;* Barclay, *supra,* n. 66.

plan is interrupted by the fact that each participating trust owns a share in each of the different securities in which the fund is invested. As each new trust is admitted to participation it receives a fractional interest in the securities. This necessitates an almost perpetual process of purchasing and selling as between the different trusts unless definite mingling dates are established.[70] Undoubtedly definite mingling dates are established in most cases, to overcome this difficulty.

Withdrawals and redemptions may also complicate the machinery. When withdrawals are made there is necessary a certain liquidation of quick assets in order to provide the funds to pay the withdrawing party. Normally this factor may be of minor importance as incoming funds will be ample to care for redemption. However, in times of stress, or depression, or when a lack of confidence becomes evident the situation might become acute.[71]

This problem may be surmounted by proper management methods. If there are a large number of revocable trusts a greater degree of liquidity must be maintained. The whole question is largely one of managing the investment account so as to provide funds to meet all requirements as they arise.[72]

THE TAX SITUATION.—With respect to taxation, there is considerable uncertainty surrounding commingled funds. This question may be significant at the present time in view of the search by governments to find additional sources of revenue. The uncertainty is apt to remain for some time as there has been no tax decision pertaining to mingled funds.

A recent ruling of the Bureau of Internal Revenue has made clear the status of the trust form of commingled fund. The Bureau ruled that the income received by the trustee of the commingled fund would not be taxable to trustee or taxed at the rates applied to corporations. The income from such a fund is taxable only to the ultimate beneficiaries as if received directly by the participating trusts and without intervention of the commingled fund.

In the case of the corporate form the tax situation is not clear. Normally where a corporation is formed for the mingling of trust funds, the income of the fund is taxed to the corporation at the corporation income tax rate and to the individual trusts as dividends.[73] There are also other taxes connected with the cor-

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[70] Perkins, *op. cit.;* Smith, Maclin F., *op. cit.*
[71] Smith, Maclin F., *op. cit.;* Perkins, *op. cit.*
[72] Smith, Maclin F., *op. cit.*
[73] Peter, *op. cit.;* Smith, Maclin F., *op. cit.*

poration such as state franchise taxes, share taxes, etc. One writer states that "the tax problem was essentially solved by issuing debenture income bonds as well as stock."[74] Since the interest on the income bonds is deductible for the gross income of the corporation in calculating the federal corporate income tax, the bulk of the income is non-taxable.

Although this procedure seems technically to solve the problem, it has not been ruled upon. Thus, it is possible that the government may rule that it is a mere tax subterfuge and disallow the practice. If so, there will be the additional corporation income tax to pay. If the practice holds, the corporate form is, in some jurisdictions, a highly satisfactory plan.

CLERICAL LABOR AND EXPENSE.[75]—The factor of clerical labor and expense is an important aspect of the commingled fund problem. One of the basic purposes of this plan is to make medium-sized and small accounts more profitable and to lower the cost of administration. If this is not accomplished its mission is decidedly weakened.

In many respects clerical labor and expense are reduced. For instance, the plan reduces the labor involved in making reviews of accounts and in keeping books as regards income and purchases and sales. Some clerical work will be the same. The labor and problems involved in accounting for income for tax purposes, however, will be greatly increased. When full consideration is given to the factors "it would appear that clerical labor is greatly increased when the commingled fund is set up under a declaration of trust."[76]

The situation is considerably different where the commingled fund is incorporated. Here, corporate records are kept which make the whole accounting procedure different from that used for trusts. The corporate form simplifies the accounting for tax purposes. Under this plan the individual trusts receive only one class of income, that from debenture income bonds. Therefore it does not have to be analyzed as between the various classes of taxable and non-taxable income.[77]

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[74] Barclay, George C., "Valuable Experience with Commingled Funds for Trust Estates," *Trust Companies,* Vol. 56 (Feb. 1933), p. 183.

[75] This material is based on and follows closely the article by Clifford, *op cit.;* See Smith, Maclin F., *op. cit.*

[76] Clifford, *op. cit.* See Smith, Maclin F., *op. cit.,* for a good discussion of this question. He states that "the accounting problems encountered in this plan are extremely complicated."

[77] Ward, *op. cit.;* Peter, *op. cit.;* Perkins, *op. cit.;* Barclay, George C., "Valuable Experience with Commingled Funds for Trust Estates," *Trust Companies,* Vol. 56 (Feb. 1933), p. 183; Clifford, *op. cit.*

Edward L. Clifford[78] asked five banks which operate commingled funds for their opinion regarding the effect of commingling upon clerical expense. "Of the five banks replying, two stated that clerical expense was not decreased and three that it was decreased. Of the two answering in the negative, one uses the corporate form and one the trust; of those replying in the affirmative, two use the trust form and the third has both. The bank having both forms stated that, in the case of the incorporated fund, clerical expense was reduced considerably; they stated that, in the case of the trust, there was 'considerable bookkeeping' but that this expense did not increase materially as the fund grew. Both of the banks replying in the negative operate comparatively small funds, whereas two of those replying in the affirmative have very large funds. Again, one of the two banks in which clerical expense was not reduced stated that they did not believe that it could be reduced even in very large funds; the other bank, which used the corporate form, believed that a reduction would take place in funds of over $5,000,000."

In general this evidence "seems to show that clerical expense either has been reduced or could be reduced, provided that sufficient size was obtained." A number of banks, however, have not adopted the plan "because they felt that expenses would be increased."[79] Mr. Clifford concludes that a reduction in clerical labor and expense would come primarily from a special accounting system rather than from commingling.[80]

EXPERIENCE WITH THE COMMINGLED FUND PLAN.—Some evidence as to public reaction to the commingled fund plan is available from the experience of three trust companies.[81] Information furnished by the Equitable Trust Company of Wilmington, Delaware, shows that its "Fund A" contains 23 per cent of common stocks, and 32 per cent of preferred stocks, the remainder consisting of corporate bonds, municipal bonds, and real estate mortgages.[82] Eighty-eight per cent of the unfunded

[78] Clifford, *op. cit.*

[79] *Ibid.*

[80] *Ibid.*

[81] The experience of the Brooklyn Trust Company in operating its "Composite Fund" for the period May 1929 to Jan. 1931, is described in *Trust Companies*, Jan. 1931, p. 31. The fund had shown a steady growth, increasing from 4,508 units on May 31, 1929, to 122,995 units on Jan. 1, 1931. Liquidating value of the units was $87.09 Dec. 31, 1930, compared with $99.79 Jan. 1, 1930, a depreciation of 12.7 per cent. The fund showed a substantial yield, averaging over 5.50 per cent. The composition of the fund as of Dec. 31, 1930, was as follows: bonds and notes, 23.31%; preferred stocks, 40.62%; common stocks, 27.39%; mortgages, 8.64%; cash and loans, 0.04%.

[82] Ward, *op. cit.*, p. 290.

insurance trusts created with the Equitable Trust since July 1, 1930, specifically authorize investment in "Fund A"; 82 per cent of all other trusts under agreement, established in the same period, likewise authorize investment in this fund. Of all the wills naming the Equitable Trust as sole trustee, written or amended since July 1, 1930, 74 per cent specifically authorized participation in "Fund A."[83]

The City Bank Farmers Trust Company's Fund C, a corporation, has issued both debenture income bonds and stocks. Participations in this fund since May 1, 1930, are as follows: 1.3 per cent of the living trusts created in 1930 authorized the fund; in 1931, the proportion rose to 19 per cent; in 1932, however, the ratio dropped a little because the company accepted fewer small trusts than heretofore. The proportion of new life insurance trusts authorizing the trust were 13 per cent in 1930, 48 per cent in 1931 and 55 per cent in 1932. Data regarding wills are not available.[84]

As yet there is only meager information concerning the yield and investment experience of mingled funds. However, the City Bank and Farmers Trust Company has published some significant information. It has worked out an index as a check on the management of Fund C on a declining market. According to this Company the index represents "a weighted average of cash, bonds and common stocks, representing respectively 35 per cent, 50 per cent, and 15 per cent of the total starting index. On the basis of 100 on May 1, 1930, this index fell 34½ per cent to June 1, 1932, and 24.7 per cent as of today. Our Fund C suffered a maximum depreciation on June 1, 1932, of 32½ per cent. The present day depreciation is about 24 per cent. Another mingled fund had a maximum drop last summer, in slightly less than two years, of 51½ per cent and at the present time of 41½ per cent. This particular fund has always held a much larger proportion of preferred and common stocks than ours. For still another the figures are 31 per cent last summer and 19 per cent now."[85]

As to yield, the same Company states that they have "figures showing that the original yield of most funds was about 5 per cent, that the original participants are now receiving about 4 per cent on their investments, while the yield on present values varies

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[83] Ward, *op. cit.*, p. 292. Ward says that "when you consider these figures, bear in mind that we have never pushed these funds."

[84] Barclay, George C., "Valuable Experience with Commingled Funds for Trust Estates," *Trust Companies*, Vol. 56 (Feb. 1933), p. 186.

[85] *Ibid*, p. 187.

from 5¼ per cent to 6¾ per cent. This wide discrepancy is due to variations of investment policy between different funds."[86]

A STUDY OF INDIVIDUAL TRUSTS.—The principal advantage emphasized for the commingled fund plan is that it will be highly beneficial for small and medium sized trusts. Where these trusts are administered individually it is claimed they cannot be adequately diversified or supervised. Consequently it is alleged that the investment accomplishment for small and medium sized trusts is less satisfactory than for larger trusts. In this connection, what has been the results of trust institution administration of individual trusts?

This is shown in a study of 196 testamentary trusts from five cities.[87] There were forty-six trusts of less than $25,000 in size and fifty trusts varying from $25,000 to $75,000, or a total of eighty-six comparatively small sized trusts. The remaining 110 trusts were larger than $75,000 in size. The study shows no striking differences in the distribution of investments for the different groups of trusts regardless of size. The distribution of investments according to stocks, bonds, real estate obligations, etc., and according to fields—governmental, railroad, utility, industrial, real estate—were approximately the same for the various groups. There were six groups of trusts arranged according to size.

There was considerable difference in the number of items contained in the trusts under $75,000 in size compared with those above this figure.[88] The average number of items in the portfolios of the 196 trusts in the last year for which data were available was approximately twenty-six. For the eighty-six trusts under $75,000 in size the average was approximately sixteen. The thirty-six trusts containing less than $25,000 averaged thirteen items. While the data show that in general, risks were less widely distributed in the small trusts than in the relatively large ones, it is doubtful if this difference could be measured in investment results.

The income return for the eighty-six trusts under $75,000 averaged approximately the same as for the 110 trusts ranging above $75,000 in size. Each group averaged approximately 5.8 per cent.[89]

Sixty-five out of eighty-six, or 75.6 per cent, of the trusts

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86 *Ibid.*

87 See Chs. X, XI.

88 See Ch. XII for full analysis of diversification of the 196 trusts.

89 See Ch. XIV for analysis of the income return for 190 trusts by groups according to size, etc.

below $75,000 showed a gain in principal, while only seventy-seven out of 110, or 70 per cent, of the trusts greater than $75,000 had an increase in principal. The results for the trusts under $25,000, compared favorably with the other groups on this point.[90]

[90] See Ch. XIV for data on the principal of the trusts.

Chapter IV

LEGAL ASPECTS OF TRUST INVESTING IN FIVE JURISDICTIONS—TRUST INSTRUMENTS

TRUST investing at best is a difficult and perplexing problem. It is no small task for the trustee to invest trust funds in such a manner that they will be safe and yield the highest return, consistent with safety, to the beneficiary. Investment policies are constantly changing; the fields of safe, profitable investment are not clearly demarcated; and the constantly shifting economic sands make it impossible to use rule of thumb methods in carrying out any permanent investment policy. Indeed the problem has not been made less difficult by the legal rules and regulations that have been created by the various states, even though the law may endeavor to assure, so far as feasible, the independence of the trustee. Not only must the trustee in his selection of investments consider the economic factors involved but he must also consider the statutes and court decisions of the state in which the trust is operated.

LEGAL FACTORS IN THE SELECTION OF INVESTMENTS.—The trustee is governed by three general factors in his choice of investments; first, by the instrument creating the trust; second, by the statutes of the state in which the trust is to be executed; and third, by the interpretation of the law as set forth in the decisions of the courts of the state. If the instrument of trust prescribes the powers and duties to be exercised by the trustee with respect to investments, the trustee must follow the directions and exercise the powers thus given. In the absence of such directions and powers, however, and commonly they are lacking, the trustee must invest the funds in accordance with the laws of the state in which the trust is being administered, or abide by the decisions of the courts of that state. In the event that there are no directions in the trust instrument, no statutory provisions or court decisions in relation to investments, the trustee is governed solely by sound discretion and good faith.

There are marked differences in both statutes and court decisions in the various states regarding trust investments. However, the discussion of the legal aspects of trust investing contained in this treatise is not intended to give a comprehensive

view of the subject, but merely to set forth the legal basis and rules for trust investing as exemplified by the law in New York, Massachusetts, Illinois, Ohio, and Missouri. In this Chapter we shall consider the rôle played by the trust instruments of the 196 trusts representing five states. In the following chapters will be set forth the statutes and the body of court decisions of the five jurisdictions.

THE TRUST INSTRUMENT.—In view of the fact that the creator of the trust has unlimited authority to direct how the trust fund may be invested, the duties of the trustee may be seriously affected or wholly controlled by the directions in the trust instrument. The creator's power to prescribe how the fund shall be invested is not restricted by the various state statutes which have described more or less in detail what investments are "legal" for trust funds. The statutes of the state concerned generally set forth a list of trust investments which are intended to govern the trustee in situations for which the instrument does not otherwise provide. If the creator of a trust prescribes how investments shall be made, the trustee's duties with respect to investment are to be ascertained from the interpretation of the instrument and not from the rules of law.

CLASSES OF TRUST INSTRUMENTS—DISCRETIONARY TRUSTS.—In general, the provisions of trust instruments may be classified into four categories. The first class comprises those instruments that give the trustee complete discretion, conferring on him sole authority and responsibility for retaining or selling the original investments, for changing investments and making subsequent investments, or for reinvesting. In this case the trustee only can choose, purchase or sell the investments. In this type of trust the trustee is not restricted to "legals" of the state or to any specified type of investment, but is governed only by sound discretion and good faith.

LEGAL TRUSTS.—Legal trusts are broadly of three types. First are those trusts whose instruments definitely restrict investments to "legals" of that state. Second is the class of instruments which gives no instruction as to the type of investment to be selected. In the third type the instrument definitely limits the selection of investments to prescribed types. In such trusts most states hold that the investments must be confined to "legals." Massachusetts holds, however, that such trusts give the trustee broad discretionary power.

CONSULTATIVE TRUSTS.—A consultative trust is one in which the trustee is empowered to select the investments but is restrained from acting until he has obtained the approval of a

designated person. The trustee must take the initiative in supervising the assets and determining a course of action, but he must have his plans approved. The designated party cannot take over the management of the trust portfolio or direct the trustee to buy or sell investments. While the trustee may consider suggestions from such parties, he has the right to refuse to act on them.

In such trusts a provision is commonly found granting the trustee the right to act in unusual situations without the consent of the designated party, if the trustee's recommendations are not acted upon within a certain period.

DIRECTION TRUSTS.—The fourth type of trust is known as a direction trust. In such trusts not the trustee but another party who may be the grantor, some relative, banker, or other person, not a party to the trust, is given power over the trust principal regarding investments. This party has the management of the investments; the trustee merely executes his orders. In following such instructions the trustee usually incurs no liability or responsibility for any losses. He should not, however, rely too greatly upon this policy. Complete indifference may not be good practice; there are instances in which the trustee should refuse to act.

PROVISIONS OF 196 TRUST INSTRUMENTS FROM FIVE STATES.—It is difficult to classify trust instruments on the basis of their investment provisions for two reasons. First, they must be judged in the light of the law of the particular state. For instance, if a trust instrument is silent as to investments, New York requires the trust principal to be invested in "legals" while in Massachusetts the trustee would have full discretion. Second, the instrument may contain involved provisions concerning many aspects of investing, ranging from those allowing a limited number of "legals" to those permitting a wide list of securities which virtually give the trustee discretionary powers. Of the 196 trusts analyzed in this study, 110 trust instruments gave the trust institution sole discretion as to investments. Of this number Boston contributed forty-one; Cleveland, twenty-six; Chicago, nineteen; St. Louis, thirteen; and New York, ten. A typical example of such discretionary powers is as follows:

> I give full power and authority to sell, lease, repair, convey, invest and reinvest (in real or personal property) to convert and reconvert with full power to vary securities as my trustee shall determine any property forming a part of said trust estate; to receive, buy or otherwise acquire and invest in real estate and any interest in the same, bonds, debentures, shares of

> stock, trust certificates, receipts of trustee, mortgages, promissory notes, bills of exchange, securities of United States Government, or of any foreign government, or of any state, county or city, or of any public or private corporation and in any and all other forms of property, real, personal or mixed that are not known or may hereafter be devised, whether such property be beyond the jurisdiction of any court having charge of the trust estate and whether such property be such as courts of law have been want to sanction for the purpose of investment of trust funds.

Another instrument granting full discretionary power reads:

> I give said trustee full authority to invest and reinvest as in its judgment it may deem proper.

The remaining eighty-six instruments restricted the investment powers of the trustee in some manner. Some prescribed that legal investments only should be made; others gave specific directions as to the type of security which could be purchased; a few gave the trustee broad investment powers but required the written consent of one or more interested parties before making the investment; while a number were silent as to investments.

An example of a trust instrument which specified legals only is as follows:

> The trustee is empowered to sell any property—and to invest and reinvest the same or the proceeds thereof in securities authorized by the laws of the State of New York for the investment of trust funds.

Examples of trust instruments containing specific directions as to the types of investment permitted follow:

> My trustee shall invest such sum and keep same invested in such safe and productive securities as shall seem best and profitable, which securities or investments may be either or any of the following: First mortgage loans on real estate in the United States or territories thereof; bonds of any city, county or state or of the United States; national bank stocks, or stock of the .... Machine Company; or notes or debentures secured by pledge of any such, with safe margins, or may be registered first mortgage bonds of some railroad company or companies in the United States.
>
> My trustee is authorized to sell any real estate at such time and on such terms as it shall deem advisable, and may lease the same. To retain any of my securities and to invest any moneys in preferred stock of railroad corporations paying divi-

> dends on their common stock and which shall have paid dividends for six years continuously prior to said investment; or in bonds of railroad corporations, or any other corporation secured by first mortgage on improved real estate.

The following instrument gave the trustee rather broad investment powers but required the written consent of the donor's wife to invest.

> I give full power to the trustee to retain as permanent investments of the trust any of the securities of which I may die possessed and with the consent of my wife in writing to invest any funds at any time on hand for investment in similar securities or in any other way or form.

TRUST INSTRUMENTS OF EACH OF THE FIVE JURISDICTIONS.—Since there are considerable differences in the investment provisions of the trust instruments of the five jurisdictions a more detailed analysis of the 196 instruments according to the practice of the five states which they represent is in order.

NEW YORK TRUST INSTRUMENTS.—In the examination of eighty trust instruments in the state of New York, it was found convenient to classify them into six groups. The first group, containing nineteen trusts, made no mention of investments, except that in four instruments a clause was inserted to allow the sale and transfer of real estate. The second group, comprising twelve accounts, said nothing about retaining investments received in trust, but prescribed the type of investment in which the trustee could invest:

> To invest in United States Bonds, or bonds of the several states, or in first mortgages, bonds, or capital stock of any railroad company in the United States which at the time of investing, has paid for five consecutive years immediately preceding, dividends upon its capital stock . . . and in bonds secured by mortgage on improved real estate in the Boroughs of Manhattan, and the Bronx of the city of New York, which at the time of investment shall not exceed 60 per cent of the appraised value of the property.

The third group, fifteen trusts, specifically empowered the trust institutions to continue any investments which had been received in the inventory—all investments, however, to be in legals:

> To retain any and all property, or sell if they deem it advisable, and reinvest the proceeds in legals; to sell, mortgage, or lease for a term of years all property real or personal.

In the fourth group, seventeen trusts, trustees were authorized to retain the grantor's investments. The trustees were also given full discretionary power to invest and reinvest, but such powers were limited to types of investment set forth in the instrument:

> To invest and reinvest in bonds secured by first mortgage upon real estate wheresoever situated, and whether such bonds are executed by individuals or corporations within or outside New York State, and to retain property or any part of it in such investments as they may find it invested in at the time of my death.

The terms of the trusts comprising the fifth group of six accounts clearly authorized the trustee to retain as investments any of the securities of which the grantor may die possessed. These accounts gave broad investment powers to the trustee on condition that the investments be approved in writing by some interested party such as the testator's wife or the person entitled to the income:

> The trustee is authorized to keep my personal estate in such investments as it may be in at the time of my decease, and to sell, call in, change, invest and reinvest all such securities and investments whenever and as often as it may deem necessary, and to make investments and reinvestments of trust moneys in such other securities besides those recognized by law, as it may think proper and which shall be approved in writing by the person or persons entitled at the time to the income of the trust estate, and if made with such approval, the trustee shall not be responsible for any loss resulting from the making of such investments.

In the last group, composed of eleven trusts, the trustee was given power to hold as investments any securities which the testator held, and to invest in similar, or any other securities in which trustees are not permitted by law to invest:

> The trustee shall have power to invest and reinvest the same or the proceeds thereof in railroad, municipal, or government bonds, income-bearing securities, and to retain, sell, collect, sue for, alter and change the investments. It being my intention that said trustee . . . shall have as complete power to retain old investments or select new as I would or might have had if I had remained living, and without the restrictions usually imposed by law upon trustees with respect to the investment of trust funds . . .

In all the New York trusts selected for analysis, the making of investments was a function of the trust institution alone. In certain cases, however, the trust institution was given the right to select specific investments on condition that these investments be approved by another party, designated by the trust instrument.

If the instrument says nothing on the subject of investments, either as to the character of new investments permitted or the retention of investments received in the trust, a trust institution in New York State may follow only the direction of the state law.

In several trust instruments, the trustee was instructed not to dispose of specific investments received in trust from the grantor before a designated time, say two or three years. When real estate was included in the trust estate, the trust institution was usually given broad powers to hold, mortgage, lease, repair, or sell such property. In a few trusts, the wishes of the beneficiaries were to guide the trustee in such matters. Provision in several trust instruments asked the trust institution to make no changes in the securities received in trust unless it learned facts or circumstances making the securities unsafe.

Several trust instruments had a clause to the effect that the trustee is "not liable for any loss or depreciation in value of any investments made;" or "said trustee is not accountable for any loss." Usually such provisions are not quite so sweeping; commonly they specify the conditions whereby the trustee is released from liability in connection with investments. A few trusts incorporated instructions regarding principal and income when stock dividends arise, but usually such provisions were absent. A few trusts specified what commissions trustees should receive.

MASSACHUSETTS TRUST INSTRUMENTS.—In view of the fact that few of the trust instruments examined in Massachusetts contained any definite instructions, we may presume that their influence upon the investment policies of trustees was slight. A Massachusetts court has ruled, however, that if instructions regarding investments in certain securities are contained in the trust instrument, they must be followed explicitly.[1]

Of the forty-one trusts examined, no specific instructions were contained in a single one. About 35 per cent of the trusts made no mention of investments; 45 per cent conferred on the trustee full discretion regarding investments; and 20 per cent contained various qualifications, such as "to keep the invest-

[1] Worcester City Missionary Society v. Memorial Church, 186 Mass. 531 (1904).

ments in good securities," or "to invest and reinvest in safe, income-producing securities." In Massachusetts, if the instrument does not contain instructions regarding investments, the trustee may invest in such securities as he deems appropriate. Here, then, the "prudent-man" theory is in full force, and we may conclude that the terms of the trust had no positive influence in determining the investment policy of Boston trust institutions.

ILLINOIS TRUST INSTRUMENTS.—Of the twenty-three trust instruments examined in Chicago, twenty-one gave full discretionary powers to the trustees, while only two were at all qualified. Consequently it appears that trustees in Illinois had very broad powers of investment.

Just how wide and sweeping are the powers granted a trustee in Illinois may be seen from this excerpt from a trust instrument. He may

> invest and reinvest the trust funds and the proceeds therefrom, or from any part thereof, in municipal or government bonds, or in the bonds or other obligations of any railroads or other corporations, income-bearing stocks, mortgages, or any other securities and property, and to alter and change the investments thereof . . . Said trustee, in the management of said trust estate shall have as complete power to select investments as I would have had if I had remained living. He is expressly authorized and empowered to continue the said trust estate invested in the same manner and in the same securities or property in which it may be invested when received by said trustee . . .

Even the qualified trust instrument gave the trustee rather wide powers, for it provided that

> the principal shall be invested by said trustee in interest-bearing securities considered by him to be good, but I authorize said trustee to continue to hold as part of the trust funds any stock or securities received from the executor, and further authorize said trustee to sell any real estate.

OHIO TRUST INSTRUMENTS.—Of the thirty-four trusts examined in Cleveland, twenty-six gave full discretionary power to the trustees, six authorized investment in "legals" only, while two made no mention of the types of investments to be made. An example of each type of provision follows:

> *Discretionary.*—The trustee was given authority to sell and dispose of all property, to invest and reinvest all sums of money coming into my possession according to its absolute discretion

in such loans, securities and real estate as it shall deem for the best interests of my estate, irrespective of any statutes or rules of chancery courts now or heretofore limiting the class of investments for trust companies, or trustees generally, giving to the trustee absolute discretion as to the terms, conditions, and rate of interest in respect to such investments, with the right to retain by way of investment any property or securities coming to it from my estate, without liability for depreciation in value, and with the right to vary or transpose investments so made into others of like or similar nature.

Legal.—All investments and reinvestments of the trust estate made by said trustees shall be in such forms of property or securities as are prescribed by the laws of the state of Ohio for the investment of the trust funds of trust companies, or in participation therein, but my trustee may continue my estate, or any part thereof if they deem it wise.

MISSOURI TRUST INSTRUMENTS.—Of the eighteen trust instruments examined in St. Louis, thirteen gave full discretionary powers as to investments; two made no mention of investments; only one was qualified; while two provided that the trustee must consult one of the grantor's relatives before making investments. Examples of each type are given below:

Full Discretion.—The trustee shall have full power to dispose of the trust estate as he shall deem meet and proper; it being intended hereby to give said trustee full and complete authority to manage, invest, and reinvest said trust estate according to its sole judgment and discretion, without any limitations upon its power and authority to do so.

Qualified.—The trustee shall have power to dispose of said trust property as if it were the sole owner, but shall not at any time invest any of the proceeds in any speculative stocks, bonds, or securities, but shall not be limited in investments to those required of trustees by law.

Consultative.—The trustee shall have full power to dispose of said trust estate . . . and full authority to invest, and from time to time to reinvest . . . and to change any and all investments according to its judgment and discretion provided, however, that no such change of investment shall be made by the trustee without consent of all my surviving daughters.

Chapter V

LEGAL ASPECTS OF TRUST INVESTING IN FIVE JURISDICTIONS—STATUTES

When considerable numbers of individuals began to accumulate capital in substantial sums, as the economic order grew more complex, and as the investment problems of individuals became more involved, trust service developed in magnitude. With these developments the problems of trust investing became more complex. The failures of trusteeships were numerous.[1] The estate which promised security to the beneficiary was frequently lost as a consequence of bad judgment, negligence, mistakes or lack of skill in the investment of the assets. There was an urgent need for effective regulation of trust administration, especially with regard to the investment of trust assets. But there were no definite rules or directions for the trustee to follow. Few cases had been presented to the equity courts, therefore, the rules of court to serve as guides were quite limited or non-existent in most states, until nearly the turn of the century. Consequently legislatures in a number of states passed laws controlling investing by placing certain statutory limitations on the investment powers of a trustee.

Purposes of Statutory Control.—The statutes of the state concerned may expressly set forth the duties of trustees regarding investments. In many states legislatures have approved of certain securities which are considered lawful investments for trust assets. Unless otherwise provided by the trust instrument, trustees are required to place trust assets in these securities only. There are, however, many trust instruments which contain few or no directions regarding investments. When the creator of the trust fails to incorporate instructions as to how the assets should be invested, the trustee is required to follow the statutes of the particular state. Thus, no trust investment should be made without the trustees carefully considering the statutes of the state within which the trust is being administered. If he invests in other than legal securities he does so at his own risk and must

[1] See *Legislative Documents of the Senate and Assembly of New York*, 53d Sess., 1830, Vol. II, Doc. No. 84, pp. 3-7, quoted in Smith, James G., *Trust Companies in the United States*, (1928), p. 252 ff.

bear any resulting loss. It makes no difference whether or not the trustee invested with ordinary care and prudence; he is liable just as if he had disregarded the instructions contained in the instrument and had invested in securities not specified therein.

Another objective underlying statutory control of trust investing was to favor business of the particular state. The majority of states have followed this practice by creating statutes favoring local real estate mortgages or bonds, municipal bonds, and corporate bonds. The statutes of many states have also specifically prohibited investments where the property is beyond the jurisdiction of the courts of the state in which the trust is to be administered.[2]

Since the statutes of the states play such an important rôle in the investment of trust assets, it is the purpose of this Chapter to give a brief survey of these laws in the five states concerned in this study.

STATUTORY STATUS OF CERTAIN INVESTMENTS IN THE FIVE JURISDICTIONS.—The statutory status of certain investments in the states included in this study, namely, New York, Massachusetts, Illinois, Ohio, and Missouri, may be seen from the following brief summary. In each of these five jurisdictions the statutes authorize, as proper investments for trust funds, United States bonds, state bonds, municipal bonds in the individual state, and first mortgages of real estate located in the state in which the trust is created. Municipal bonds of other states are also legal for trust funds in each of the five jurisdictions, except that Missouri has limited this type of investment to a greater extent than have the remaining four states. Certain railroad bonds are legal in each state, although Missouri has again limited this field considerably more than have the other states. Certain utility bonds qualify in four states, but Missouri has not made them legal investments. Industrial bonds are accepted in Illinois, Massachusetts, and Ohio but they are not on the legal list in Missouri and New York. The statutes of Massachusetts and Ohio permit trust investments in bonds of foreign nations. Stocks of private corporations are authorized in Massachusetts and Ohio but not in the other states. Bank and trust company stocks are legal investments for trusts only in Massachusetts. New York and Ohio statutes sanction participating mortgages, but in Massachusetts, Illinois, and Missouri the statutes are silent on this matter. Mortgages on property in adjoining states are

[2] At present this prohibition applies largely to investments which have a local character, like real estate.

authorized only in Massachusetts, Illinois, and Ohio. Illinois is the only jurisdiction whose statute gives the trustee the right to continue investments of the decedent.

This enumeration of the statutes affecting certain investments is far from complete. In practically every case there are a number of qualifications to be considered regarding each type of investment in each of the jurisdictions. The statutes in the states which authorize trustees to invest in municipal obligations of other states, railroad, public utility and industrial corporation bonds, and stocks of private corporations, limit such investments to corporations which meet certain financial tests as to earnings, dividends, stability, etc. Thus, decisive answers may be given regarding the legality or illegality of a security for trust investment in a certain state only after a careful consideration of the statutes of that state.

STATUTES PERTAINING TO TRUST INVESTING IN FIVE JURISDICTIONS.—To present a more complete picture of the statutory control of trust investing, in the following sections, a synopsis is given of the statutes of each state studied. These greatly differing statutes illustrate the ways in which legislatures have regulated the duties of trustees regarding investments. The analysis is concerned with the law as it existed in 1933.

NEW YORK STATUTES.[3]—The laws of New York governing investment of trust funds by individuals are also applicable to trust institutions. The Banking Law provides that "all investments of money received by such corporation . . . shall be at its sole risk, and for all losses . . . the corporation shall be absolutely liable, unless the investments are such as are proper when made by an individual acting as trustee . . . or such as are permitted in and by the instrument or words creating or defining the trust."[4]

INVESTMENTS LEGAL FOR TRUST FUNDS.—The statutes provide that a trustee may place trust funds in the following investments:

1. Shares of a savings and loan association organized in New York and having an accumulated capital of $100,000 or more. The investment of any one estate or trust in any one association shall not exceed $10,000.[5]

2. Bonds and mortgages on unincumbered real property in

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[3] New York statutes pertaining to trust investments are found at various points in the Consolidated Laws.

[4] Banking Law 1914, Ch. 369, Sec. 188, Subd. 7, as amended to date.

[5] Laws of 1909, Personal Property Law, Ch. 45, Sec. 21, as amended to date.

New York worth 50 per cent or more than the amount loaned thereon.[6]

3. Shares or parts of such bonds and mortgages provided they shall not be subordinate to any other shares or parts or to any prior interest.[7]

4. Investments in bond and mortgage by any trust company as fiduciary may be made by apportioning or by transferring to any estate or fund so held a part interest in a bond and mortgage held by or in the name of such corporation.[8]

5. Obligations of Port of New York Authority for:

(a) Bridge across Hudson River between New York City and Fort Lee.[9]
(b) Bridge across Kill Van Kull between Bayonne, New Jersey and Staten Island.[10]
(c) Steamship terminals.[11]
(d) Holland Tunnel and Midtown Hudson Tunnel.[12]

FUNDS AWAITING INVESTMENT—INTEREST ON.—On all sums of money not less than one hundred dollars, collected and received by a trust company in any fiduciary capacity, or as a depositary or money paid into court, interest shall be allowed at not less than 2 per cent per annum.[13]

EXCHANGE OF MORTGAGE INVESTMENT.—Trustees who have made or held an investment in a bond secured by mortgage on real property or share or part thereof are authorized, without court order or other authority, to exchange such bond and mortgage or share or part thereof and any rights in respect thereto for bonds of Home Owners' Loan Corporation. Such bonds are authorized and lawful investment for any and all purposes.[14]

CONVEYANCES TO CERTAIN CORPORATIONS IN EXCHANGE FOR CERTAIN STOCKS AND BONDS AUTHORIZED AND REGULATED.—Whenever a trustee or other fiduciary is entitled to receive the proceeds from the disposal of real property made pursuant to

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[6] *Ibid.* See also Laws of 1909, General Construction Law, Ch. 27, Sec. 25-b. Provisions regarding the modification and extention of mortgage investments are contained in the Laws of 1909, Real Property Law, Ch. 52, Sec. 277, added by Laws of 1933, Ch. 319.

[7] Laws of 1909, Personal Property Law, Ch. 45, Sec. 21, as amended to date.

[8] Banking Law 1914, Ch. 369, Sec. 188, Subd. 7, as amended to date.

[9] Laws 1926, Ch. 761, Sec. 8.

[10] Laws 1927, Ch. 300, Sec. 8.

[11] Laws 1931, Ch. 47, Sec. 13.

[12] *Ibid.*

[13] Banking Law 1914, Sec. 188, Subs. 11.

[14] Real Property Law, Ch. 52, Sec. 278, added by Laws of 1933, Ch. 792.

power contained in a deed or will, or pursuant to law, and the property has been or is about to be conveyed to a corporation formed or to be formed for such purpose, and all adult beneficiaries and all adult persons having a vested interest in the proceeds of the sale, desire to agree that their shares shall be invested in the stock and bonds of such corporation, then the fiduciary may, with the approval of the supreme court, invest the trust fund in the stocks and bonds of such corporation.[15]

INVESTMENTS LEGAL FOR SAVINGS BANKS.[16]—Since trustees in New York may invest in securities which are legal for savings banks,[17] the salient provisions of the banking law relating to investments by such banks will be briefly set forth. These investments include the following:

1. United States Bonds: The stocks, or bonds, or interest-bearing notes or obligations of the United States, or those for which the faith of the United States is pledged to provide for the payment of the interest and principal, including the bonds of the District of Columbia.

2. New York State Bonds: The stocks, or bonds, or interest-bearing obligations of this state, issued pursuant to the authority of any law of the state.

3. Bonds of Other States: The stocks, bonds or interest-bearing obligations of any state of the United States, upon which there is no default and upon which there has been no default for more than ninety days; provided that within ten years immediately preceding the investment such state has not been in default for more than ninety days in the payment of any part of principal or interest of any debt duly authorized by the legislature of such state to be contracted by such state since the first day of January, eighteen hundred and seventy-eight, except debts representing a refunding or adjustment of any indebtedness originally contracted or in existence at that date or prior thereto.

4. New York Municipal Bonds: The stocks, bonds, interest-bearing obligations, or revenue notes sold at a discount, of any city, county, town, village, school district, union free school district, poor district or fire district in this state, provided that they were issued pursuant to law and that the faith and credit of the municipality or district that issued them are pledged for their payment.

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[15] Laws of 1909, Real Property Law, Ch. 52, Sec. 116, as amended to date.

[16] Banking Laws of 1914, Ch. 369, Sec. 239, as amended to date.

[17] Laws of 1909, Personal Property Law, Ch. 45, Sec. 21, as amended to date.

5. Municipal Bonds of Other States: First, bonds and obligations, excluding non-negotiable warrants, of a city, or of a school district co-terminous with or which includes such city, or of a county in states adjacent to New York, if they have a population of at least 10,000 and no defaults on their obligations of over 120 days during the preceding twenty-five years and whose indebtedness is not in excess of a certain per cent of the valuation of real property for the purposes of taxation.

Second, bonds and obligations, excluding non-negotiable warrants, of any city, or of any school district or county co-terminous with or which includes such city in any other of the states whose obligations are an authorized investment for savings banks, provided said city has a population of not less than 30,000, was incorporated as a city at least twenty-five years prior to the making of the investment, has not defaulted on its obligations for more than 120 days during the preceding twenty-five years, whose indebtedness is not in excess of a certain per cent of the valuation of real property for the purposes of taxation.

Obligations of cities or districts of less than 45,000 population are not legal investments for savings banks unless such a city or district has power to levy taxes on taxable real property to pay such obligations without limitation of rate or amount.

The factor of indebtedness does not apply to any city or district which has taxable real property with assessed valuation in excess of $200,000,000 and which has a population of not less than 150,000, provided such a city or district has power to levy taxes on the taxable real property to pay these obligations without limitation or rate or amount.

6. Bonds and Mortgages on Real Estate: Bonds and mortgages on unincumbered real property in New York State to the extent of 60 per cent of the appraised value thereof; and only to 40 per cent of the appraised value of unincumbered and unproductive real property.

7. Railroad Obligations:

a. Type of railroad:

(1) Must be incorporated in the United States.

(2) Must own and operate within the United States 500 miles of standard-gauge railroad line, exclusive of sidings.

(3) If mileage is less, then operating revenues shall not be less than $10,000,000 each year for five of the six fiscal years next preceding the investment.

b. Requirements as to financial conditions, etc.:

(1) Income available for its fixed charges to be not less than one and one-half times such charges for each year in five of the six fiscal years, and in the last year, next preceding the investment.

(2) In each year for at least five of the six fiscal years next preceding the investment the railroad must have paid dividends in cash equivalent to at least one-fourth of such fixed charges. If such dividends were not paid, the fixed charge requirements must have been earned one and one-half times in nine of the ten fiscal years, and in the last year, next preceding the investment.

(3) Within such period of six years the railroad corporation shall not have failed regularly to pay the matured interest and principal of all its mortgage indebtedness.

(4) Security for obligations shall be property wholly or in part within the United States.

c. The following railroad obligations:

(1) Fixed interest-bearing bonds secured by direct mortgage on railroad owned or operated by the railroad corporation.

(2) First mortgage bonds upon terminal, depot or terminal property, etc., provided such bonds are the direct obligations of, or that the principal and interest thereof are guaranteed by endorsement by, one or more such railroad corporations.

(3) Equipment trust obligations, comprising bonds, notes and certificates, issued to purchase standard equipment through equipment trust agreement. Said equipment shall be secured by an instrument vesting title to such equipment in a trustee free of encumbrance, or shall create a first lien on such equipment. Further, the owner or proper party shall be obligated by the terms of the instrument to perform certain functions regarding the equipment.

(4) Collateral trust obligations secured by other railroad bonds that are legal investment for savings banks under this section, having a maturity not less than the bonds they secure and a face amount

not less than the face amount of the bonds they secure.

(5) Certain other interest-bearing mortgage bonds, income mortgage bonds, collateral trust bonds or obligations, unsecured bonds or obligations, issued, assumed or guaranteed as to principal and interest, etc. Earnings and other financial requirements for these obligations are higher than for the previous ones.

8. Promissory Notes: Promissory notes made payable to the savings bank (a) secured by stocks or bonds in which such savings bank may legally invest its funds; (b) of a savings and loan association of New York incorporated for three years and having $50,000 capital; (c) secured by one or more first mortgages on real estate in New York; (d) secured by pledge and assignment of the passbook of any savings bank in the state of New York.

9. Real Estate: For business purposes, or in satisfaction of debts previously contracted, or purchased at sales under judgments, decrees, or mortgages held by them.

10. State Land Bank and Federal Farm Loan Bonds: Bonds of the Land Bank of the State of New York and the Federal Land Bank of the First District.

11. Bankers' Acceptances and Bills of Exchange: Bankers' acceptances and bills of exchange eligible for purchase by the Federal Reserve Bank and accepted by a qualified bank or trust company whose principal place of business is in the state.

12. Public Utilities:

a. Types of Obligations:

(1) First mortgage bonds secured by a first or refunding mortgage secured by property owned and operated by the corporation issuing or assuming them.

(2) Underlying mortgage bonds secured by property owned and operated by the corporation issuing or assuring them, provided certain other conditions are met. The aggregate principal amount of such bonds outstanding shall not exceed 60 per cent of the value of the physical property owned as shown on the books of the corporation, and subject to such liens.

b. Types of Corporations:
   (1) Must be incorporated in the United States.
   (2) Business must be to supply electrical energy, or artificial gas or natural gas in conjunction with artificial gas, etc.
   (3) Seventy-five per cent of gross operating revenues must be derived from such business, and not more than 15 per cent of gross operating revenues shall be from any one kind of business, except electricity or gas.
   (4) Corporation must be subject to regulation by the proper commission.

c. Corporation is subject to the following conditions:
   (1) It must have proper franchises.
   (2) It must be subject to regulation by the proper commission.
   (3) Outstanding full paid capital stock shall be equal to at least two-thirds of the total debt secured by mortgage lien.
   (4) Shall have been in existence not less than eight fiscal years.
   (5) Must have paid promptly matured principal and interest of all its indebtedness throughout eight fiscal years preceding investment.
   (6) For a period of five fiscal years next preceding such investment net earnings shall have averaged per year not less than twice the average annual interest charges on the total funded debt of that period. In the last year prior to the investment net earnings shall have been twice the interest charges for a full year on its total funded debt outstanding at the time of such investment.
   (7) For such period gross operating revenues shall have averaged per year not less than $1,000,000. Must have earned or paid in dividends an amount equal to 4 per cent or the equivalent of two-thirds of its funded debt.
   (8) Such bonds must be part of an issue of not less than $1,000,000.

13. Telephone Companies:
   a. Types of obligations: First or refunding mortgage bonds. The aggregate principal amount of such

bonds, plus all underlying outstanding bonds shall not exceed 60 per cent of real and personal property subject to lien of such mortgage. Not more than thirty-three and one-third per cent of the property as security for such bonds may consist of stock or unsecured obligations of affiliated or other telephone companies, or both.

b. Types of Corporations:

(1) Must be incorporated in the United States.
(2) Must be engaged in business of supplying telephone service in the United States.

c. Corporation is subject to the following conditions:

(1) Must be subject to regulation by the proper commission.
(2) Shall have been in existence not less than eight fiscal years.
(3) At no time during such period of eight years next preceding the investment shall the corporation have failed to pay promptly the matured principal and interest of all its indebtedness.
(4) Outstanding full capital stock shall be at time of investment equal to at least two-thirds of the total debt secured by all mortgage liens.
(5) Net earnings shall have averaged for a period of five fiscal years next preceding such investment at least twice the average annual interest charges on its total funded debt applicable to that period. The last year preceding the investment net earnings must be at least twice the interest charges.
(6) Gross operating revenues shall have averaged not less than $5,000,000 per year for such a period. The corporation must have earned an amount available for dividends or paid in dividends an amount equal to four per cent upon all its outstanding capital stock.
(7) Such bonds must be part of an issue of not less than $5,000,000.

A savings bank may also invest in judgments against the state and in canal contracts.[18]

[18] Banking Law, Ch. 369, Sec. 239-a.

MASSACHUSETTS STATUTES[19]—INVESTMENT OF TRUST FUNDS.—The general laws provide that trust institutions may invest in the same way as an individual trustee.[20] Trust funds shall be loaned on or invested only in authorized loans of the United States, or of any of the New England States, counties, cities, or towns thereof; or of the states of Illinois, Iowa, Michigan, Minnesota, Wisconsin, or the counties or cities thereof, or in stocks of national banks situated in Massachusetts, or in first mortgage bonds of a railroad incorporated in any New England State, located wholly or in part in the same state, provided the railroad has earned and paid regular dividends on all issues of capital stock for two years last preceding such loan or investment, or in the bonds of any such railroad company unincumbered by mortgage, or in first mortgages on real estate in Massachusetts, or upon notes properly secured,[21] or on real estate situated in Massachusetts and on personal security, on terms to be agreed upon, or in stocks, bonds, etc., of corporations or associations or trusts or of governments, both foreign and domestic.[22]

Investments shall not be made upon notes secured by deed of trust or by mortgage upon farms, etc., outside of Massachusetts except in the New England States or New York State.[23]

CREATOR OF TRUST MAY AUTHORIZE INVESTMENTS IN GENERAL TRUST FUND.—A person creating a trust may direct whether money or property deposited under it shall be held and invested separately or invested in the general trust fund of the corporation; and such corporation acting as trustee shall be governed by directions contained in the will or instrument under which it acts.[24]

TRUST GUARANTY FUND.—The directors may from time to time set apart as a trust guaranty fund such portion of the profits as they may consider expedient. Such a fund shall be invested in such securities only as the trust deposits may be invested in.[25]

INVESTMENTS LEGAL FOR SAVINGS BANKS.[26]—

1. First Mortgages of Real Estate: First mortgages of real estate located in Massachusetts not to exceed 60 per cent of the

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[19] References are to the General Laws of Massachusetts, 1932, as amended by subsequent session laws.

[20] Chapter 172, Sec. 53.

[21] Chapter 172, Sec. 51.

[22] Chapter 172, Sec. 33.

[23] Chapter 172, Sec. 34.

[24] Chapter 172, Sec. 59.

[25] Chapter 172, Sec. 77.

[26] Chapter 168, Sec. 54. General Laws of Massachusetts provide that trustees may invest "in any securities in which savings banks may invest." Ch. 172, Sec. 51.

value of such real estate. If the loan is on unimproved and unproductive real estate, the amount loaned thereon shall not exceed 40 per cent of the value of such real estate.

2. Public Funds: (a) Obligations of the United States, of Massachusetts, or of any other state which has not defaulted on the interest or principal of any legal debt within twenty-five years prior to such investment; (b) bonds or notes of a county, city, or town of Massachusetts; (c) bonds or notes of an incorporated district in Massachusetts not having a net indebtedness of over 5 per cent of the last preceding valuation of the property for taxes; (d) bonds or notes of any city in the other New England States whose net indebtedness is not over 5 per cent of the last preceding valuation of the property for taxes, or of any county or town of said states whose net indebtedness is not over 3 per cent of such valuation, or of any incorporated water district of said states which has a population of over 5,000 and whose net indebtedness is not more than 3 per cent of such valuation; (e) municipal bonds or certain refunding bonds of any city of any state which was incorporated twenty-five years prior to the investment, having a population between 30,000 and 100,000, whose net indebtedness does not exceed 5 per cent of the valuation of taxable property; (f) municipal bonds or certain refunding bonds of any city of any state of over 100,000 incorporated twenty-five years prior to such investment and whose net indebtedness is not over 7 per cent of the valuation of taxable property.

3. Railroad Bonds: (a) Bonds or notes of a railroad incorporated in Massachusetts and located wholly or in part therein and meeting certain financial conditions, or first mortgage bonds of a terminal corporation incorporated in Massachusetts whose property is located therein and is owned or operated, or whose bonds are guaranteed by such railroad corporation. (b) Bonds or assumed bonds secured by a first mortgage or by a refunding mortgage, or other bonds properly protected of a railroad incorporated in any of the New England States, provided the railroad meets certain financial stipulations. (c) First mortgage bonds, assumed first mortgage bonds or bonds secured by a refunding mortgage, of a railroad incorporated in any New England State, guaranteed by a railroad of the type described in (a) or (b). (d) Certain mortgage bonds issued or assumed by any railroad incorporated in any state of the United States, provided it meets the prescribed financial tests. (e) Certain first mortgage bonds of a railroad corporation which have been guaranteed by a railroad described in (d) if the corporation is owned and operated,

controlled and operated, or leased and operated by the corporation guaranteeing the bonds, or if the railroad guaranteeing the bonds meets certain conditions, then the issuing corporation need not be operated by said guaranteeing corporation. (f) Equipment obligations issued or guaranteed by a railroad corporation which complies with definite financial requirements, provided such securities are secured by a first lien, or by a lease and conditional sale of new standard equipment, but the securities are not to exceed 80 per cent of the purchase price.

4. Street Railway Bonds: (a) Bonds of any street railway company incorporated in Massachusetts which meets the prescribed financial tests. (b) Bonds of the Boston Elevated Railway Company provided they satisfy certain tests.

5. Telephone Company Bonds: First mortgage bonds or collateral trust bonds, the collateral being of a certain type, quality, etc., of any telephone company incorporated in any state of the United States, provided the company complies with certain financial stipulations.

6. Gas, Electric or Water Company Bonds: (a) Bonds of a gas, electric or water company secured by a first mortgage of the franchise and property of the company, provided the company complies with certain financial tests. (b) First mortgage bonds constituting the only debt of the company, or a closed underlying bond secured by property owned and operated by the corporation issuing or assuming such bond, or a refunding mortgage bond for certain purposes, being secured by a lien on property owned and operated by such corporation if they are properly protected, etc., issued or assumed by any corporation incorporated in the United States which is operating under the supervision of a proper commission and is engaged in the sale and distribution of electricity or some other public service enterprise, etc., provided the company meets certain conditions.

7. Bank Stocks and Deposits in Banks: (a) Stock of a trust company incorporated and doing business in Massachusetts or stock of a national bank located in Massachusetts, if such institutions measure up to specified standards.

8. Bankers' Acceptances: Bankers' acceptances and bills of exchange of the kinds and maturities made eligible by law for rediscount with the Federal Reserve banks, provided they are accepted by certain described banks.

9. Loans on Personal Security: Loans of specified character of the following types: (a) Notes which are the joint and several obligations of three citizens of Massachusetts; (b) notes of a corporation incorporated in Massachusetts; (c) notes of certain

public service corporations; (d) bonds or notes issued, assumed, or guaranteed by certain railroad corporations; (e) notes secured by a pledge of specified collateral.

10. Farm Loan Bonds: Those lawfully issued by Farm Loan banks incorporated under Act of Congress approved July 17, 1916.

11. Real Estate: Such corporation may hold real estate acquired by foreclosure of a mortgage owned by it, or by purchase at sales made under the provisions of such mortgages or upon judgments for debts due it, or in settlements effected to secure such debts, but for a limited time.

12. Securities Acquired in Settlement of Indebtedness: Such corporation may hold stocks, bonds, notes, etc., acquired in settlements effected to secure loans or indebtedness for a limited time.

Savings banks and savings departments of trust institutions may invest in loans upon notes secured by adjusted service certificates.[27]

Bonds and notes of the Metropolitan transit districts are legal investments for savings banks.[28]

ILLINOIS STATUTES—INVESTMENT OF TRUST FUNDS.—The general statutes of Illinois provide that investments of trustees may, when not otherwise provided by the trust instrument, be in the bonds of the United States, or in the bonds of the Home Owners' Loan Corporation, or of any of the states of the United States, or in first mortgages upon real estate in any state, or in the bonds of any county, city, or municipality in any state, or in the first mortgage bonds of any corporation of any state upon which no default in payment of interest shall have occurred for a period of five years, but no trustee shall be authorized by this act to invest trust funds in any bonds in which cautious and intelligent persons do not invest their money, and any trustee may continue to hold any investment received by him under the trust or any increase thereof.[29]

OHIO STATUTES[30]—INVESTMENTS LEGAL FOR TRUST FUNDS.—

1. Obligations of the United States: Bonds or other interest-bearing obligations of the United States, the Philippines, Hawaii, Porto Rico, the District of Columbia and bonds issued under the home owners' act of 1933.[31]

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[27] Acts, 1927, Ch. 102.

[28] Extra Session Acts, 1931, Ch. 464.

[29] Smith-Hurd Illinois Revised Statutes, 1931, as amended by subsequent session laws, Ch. 148, Sec. 32.

[30] References are to Throckmorton's Annotated Code of 1929, Supplement of 1929, Supplement of 1932 and subsequent session laws.

[31] Section 710-111.

2. Ohio: Bonds or other obligations of the State of Ohio.[32]

3. Bonds of Foreign Governments: External bonds or other interest-bearing obligations of any foreign government which has not defaulted in the payment of principal or interest within a period of twenty-five years prior to the investment.[33]

4. Bonds of Other States: Bonds or other interest-bearing obligations of any state or territory of the United States.[34]

5. Ohio Municipal Bonds: Bonds or other interest-bearing obligations of any county, town, township, city, school district, improvement district or sewer district, or other organized or political sub-division in Ohio.[35]

6. Municipal Bonds of Other States and Territories: Bonds of any city, town, county or political sub-division in any of the states, or any city of the Philippines, Hawaii or Porto Rico, which has been in existence for ten years and has not defaulted for a period of ten years previously in payment of interest or principal for a period of more than ninety days, and whose net indebtedness does not exceed ten per cent of the value of taxable property.[36]

7. Bonds or Debentures of Provinces of the Dominion of Canada: Bonds or debentures of any province of the Dominion of Canada, or of any city, town or district with a population of not less than 10,000 and a net indebtedness not exceeding 7 per cent of the last valuation for taxes, and which has not defaulted on any debt more than ninety days since 1900; bonds or obligations of any city, town or district therein whose obligations are unconditionally guaranteed by the Dominion of Canada.[37]

8. Municipal Bonds of Foreign Governments: Bonds of any governmental subdivision or city of any foreign country, with a population not less than 100,000, whose net indebtedness does not exceed 7 per cent of the last valuation of taxable property and which has not defaulted for more than ninety days on any debt for twenty-five years preceding such investment.[38]

9. Bankers' Acceptances: Bankers' acceptances of the kind and maturity rediscountable with the Federal Reserve banks.[39]

10. Bonds of Private Corporations: Mortgage bonds, collateral trust bonds, bonds or notes of any regularly incorporated

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[32] Section 10506-41.
[33] Section 710-111.
[34] Section 710-111.
[35] *Ibid.*
[36] *Ibid.*
[37] *Ibid.*
[38] Section 710-111.
[39] *Ibid.*

company, which for four years prior to investment has earned over and above all fixed charges at least double the interest charges it must pay on its outstanding obligations or if total encumbrances do not exceed 50 per cent of the actual value of the property securing said bonds or notes.[40]

11. Equipment Obligations: Railroad equipment bonds, or car trust certificates, issued in the United States or Canada, and bonds secured by first mortgages on steel steamships, not exceeding 50 per cent of their value.[41]

12. Loans Upon Mortgages: Bonds or notes secured by first mortgage on the fee simple title of improved real estate of not more than 60 per cent of its value, and 40 per cent of its value if unimproved. Real estate must be situated in Ohio or in states contiguous thereto.[42]

13. Farm Loan Bonds: Farm loan bonds issued by federal land banks and joint stock land banks.[43]

14. Stocks of Corporations: Stocks of corporations when authorized by the affirmative vote of the board of directors, or of the executive committee of such trust company.[44]

LOANS ON SHARES OF ITS CAPITAL STOCK.—This section prohibits banks and trust companies from making loans on and purchasing the shares of their own capital stock, except in certain cases to prevent loss, and further provides that any stock so acquired must be sold within six months.[45]

DEPOSIT OF MONEY PENDING INVESTMENT.—Moneys pending distribution or investment may be treated as a deposit in the trust department or may be deposited in any other department of the bank, subject in other respects to the provisions of law relating to deposits of trust funds by trustees and others.[46]

INVESTMENT IN GENERAL TRUST FUND.—In the management of money and property held by it as trustee, such trust company may invest such money and property in a general trust fund of the trust company. But it shall be competent for the authority making the appointment to direct whether such money and property shall be held separately, or any part thereof invested in a general trust fund of the trust company.[47]

LIABILITY FOR FAILURE TO INVEST OR DEPOSIT.—A fiduciary

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[40] *Ibid.*
[41] *Ibid.*
[42] *Ibid.;* Secs. 710-112, 113; 10506-41.
[43] Section 710-111.
[44] Section 710-166.
[45] Section 710-114.
[46] Section 710-165.
[47] Section 710-164.

who has funds belonging to the trust not required for current expenditures shall, unless otherwise ordered by the probate court, invest or deposit such funds according to law, within a reasonable time, and on failure so to do, such fiduciary shall account to the trust for such loss of interest as may be found by the court to be due to his negligence.[48]

INVESTMENTS LEGAL FOR SAVINGS BANKS:[49]

1. Real estate securities made upon first mortgage upon real estate situated in Ohio, or in states contiguous thereto and shall not exceed 40 per cent of the value of such real estate if unimproved, and 60 per cent of such value if improved.

2. Stocks of companies, upon which or the constituent companies comprising the same, dividends have been earned and paid for five consecutive years next prior to the investment and stocks of companies taken on a refinancing plan involving an original investment, which was legal at the time it was made; provided every such investment shall be authorized by an affirmative vote of a majority of the board of directors of such savings bank. No purchase or investment shall be made in the stock of any bank.

3. Promissory notes of individuals, firms or corporations when secured by a sufficient pledge of collateral approved by the executive committee or board of directors.

4. Ground rents or certificates of participation, or beneficial ownership in improved lands under lease for not less than twenty-five years from date thereto, provided that aggregate par amount of such rents shall not exceed the value of the land nor 60 per cent of the total value of the land and improvements.

MISSOURI STATUTES[50]—AUTHORIZED TRUST INVESTMENTS.—Investments made by any trust company as fiduciary shall be at its sole risk unless the investments are such as are proper when made by an individual trustee or such as are authorized by the trust instrument.[51]

Bonds Eligible for the Investment of Trust Funds.—Any and all bonds registered by the state auditor under the provisions of the laws of Missouri, and any and all bonds that have been or may be duly issued by any county or city having a population of over 300,000, whereon there is no default in payment of prin-

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[48] Section 10506-41.

[49] Section 710-140. Section 710-166 authorizes trust companies to invest in or loan its trust funds upon securities in which savings banks may invest.

[50] Revised Statutes of 1919, and Supplement of 1927 and subsequent session laws.

[51] Section 11801-5.

cipal or interest, are eligible for the investment of trust funds. Such investments may be made without order of court and without incurring liability for loss, except in case of inexcusable negligence.[52]

Certain sections provide for the registration by the state auditor of county, township, city, town, village, school and certain public improvement bonds.[53]

Bonds Issued Under Federal Farm Loan Act.—Fiduciaries may invest any funds held by them in bonds issued under the provisions of the act of Congress, approved July 17, 1916.[54]

LOAN OF TRUST FUND UPON ORDER OF COURT.—If, on the return of the inventory, or at any other time, it shall appear to the satisfaction of the court that there is a surplus of money in the hands of the executor or administrator that will not shortly be required for the expenses of administration, or payment of debts, it shall have discretionary power to order him to lend out the money on such terms and for such time as may be deemed best.[55]

INTEREST ON FUNDS.—Unless otherwise provided in the trust instrument, on all sums, not less than $100, which shall be held by a trust company as fiduciary, or as depositary of money paid into court, interest shall be allowed by the trust company at not less than 2 per cent per annum, compounded annually, until the money is expended or distributed.[56]

AUTHORIZED INVESTMENTS FOR SAVINGS BANKS.[57]—

1. Bonds of the United States: Bonds or interest-bearing obligations of the United States.

2. Bonds of Missouri: Bonds of the State of Missouri.

3. Bonds of Any State: Bonds of any state in the Union that has not defaulted as to principal or interest for five years prior to the investment.

4. Missouri Municipal Bonds: Bonds of any county, city, town, township, or school district of the State which has not defaulted for five years and whose bonded debt does not exceed 5 per cent of the assessed value of the taxable property.

5. Municipal Bonds of Other States: Bonds of any city, town or county of over 20,000 inhabitants in certain states, provided the entire bond issue does not exceed 5 per cent of the

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[52] Section 1069.
[53] Section 1062-1068.
[54] Section 1069a.
[55] Section 103.
[56] Section 11801-9.
[57] Section 11871.

assessed value of taxable property and no default in principal or interest has occurred for five years prior to investment.

6. Railroad Bonds: First mortgage bonds of any steam railroad operated in certain named states and having a certain income specified in the statute and which has paid the interest on its bonds for three years preceding the investment, or in the first mortgage bonds of the Central Pacific, Northern Pacific, Union Pacific, New York Central, West Shore and the Pennsylvania railroads.

7. Real Estate Mortgages: Bonds and notes on first mortgages on unincumbered real estate worth at least twice the amount loaned thereon and on unimproved and unproductive real estate not over 40 per cent of its actual value.

8. Real Estate: In real estate, subject to certain conditions named in the statute.

Chapter VI

LEGAL CONTROL OF TRUST INVESTING AS SET FORTH IN NEW YORK COURT DECISIONS

FOR the proper investment of trust funds, the trustee must look not only to the trust instrument and statutes but must pay strict attention to court decisions of the state in which the trust is operative. There is no simple rule to be easily followed in selecting investments. In the great body of court decisions, however, certain specific rules, as well as general principles, may be found which constitute reasonable guides to be followed by the trustee in making investments. Therefore, a brief summary will be formulated of the rules of guidance in some outstanding court decisions in the five jurisdictions relative to trust investing. There will be presented in this Chapter the law of trust investing as set forth in the decisions of the New York courts. In Chapter VII will be given the rules of guidance as exhibited in the court decisions of Massachusetts. Court regulations governing trustee's investments in Illinois, Ohio and Missouri will be set forth in Chapter VIII.

General Policy.—The policy of New York respecting trust investments as stated in King v. Talbot[1] has stood unquestioned to this day.[2] In this case the court said that the trustee must use with respect to trust funds "such diligence and such prudence in the care and management as, in general prudent men of discretion and intelligence in such matters employ in their own like affairs." "This necessarily excludes all speculation, all investments for an uncertain and doubtful rise in the market, and, of course, everything that does not take into view the nature and object of the trust, and the conseqences of a mistake in the selection of the investment to be made."[3] The trustee should look to the security of the fund, to the production of a reasonable income, and to the obtaining of an investment which is readily saleable.[4] If an investment is improperly made, the trustee must shoulder

[1] 40 N. Y. 76 (1869).
[2] In re Robbins' Will, 135 Misc. 220, 237 N. Y. S. 409 (1929). Here is cited a list of cases applying this rule.
[3] King v. Talbot, 40 N. Y. 76 (1869).
[4] *Ibid.*

the attendant responsibility.[5] The trustee is not, however, required to be infallible and he will not be held for the consequences of an error in judgment.[6] The propriety of an investment will, of course, be determined as of the time when it was made, and not in the light of subsequent knowledge.[7]

DUTY OF THE TRUSTEE TO INVEST THE TRUST PRINCIPAL.—Specific directions in the trust instrument are not required in order to impose on the trustee the duty of investing the trust fund. That duty is placed upon him by the law, which will not allow the fund to lie idle.[8] Further, the duty of the trustee to invest trust funds arises by implication from the trust instrument, which directs the trustee to pay over interest or income.[9] In order to do this the trust assets must be kept invested. If the trustee negligently permits the trust principal to remain uninvested he subjects himself to a surcharge for interest at the legal rate.

DIRECTIONS IN THE TRUST INSTRUMENT BINDING UPON THE TRUSTEE.—It is a well known principle that the creator of a trust has full authority to prescribe how investments shall be made[10] and the trustee must follow such directions implicitly.[11] If the grantor specifies the character of the investments to be selected, or the investments to be retained, these instructions must be followed by the trustee irrespective of what the law recognizes as legal investments. If the instrument directs that particular investments be selected, the trustee should retain any such securities, if they are already in the portfolio, or otherwise allocate the trust principal to these investments.[12] If the instrument contains provisions permitting investing in other than the commonly recognized trust investments the courts will strictly construe such provisions. Unless expressly provided for by the grantor no

[5] In re Westerfield, 32 App. Div. 324, 53 N. Y. S. 25 (1898).

[6] In re Pratt's Estate, 143 Misc. 751, 257 N. Y. S. 226 (1932); Costello v. Costello, 209 N. Y. 252, 103 N. E. 148 (1913).

[7] Crabb v. Young, 92 N. Y. 56 (1883); In re Blauvelt's Estate, 20 N. Y. S. 119; aff'd., 60 Hun 394 (1891); Costello v. Costello, 209 N. Y. 252, 103 N. E. 148 (1913).

[8] King v. Talbot, 40 N. Y. 76 (1869).

[9] In re Kohler, 231 N. Y. 353, 132 N. E. 114 (1921).

[10] In re Reid, 170 App. Div. 631, 634, 156 N. Y. S. 500 (1915). In fact the creator may reserve the right to direct the investment after the trust has begun. Rice v. Halsey, 156 App. Div. 802, 142 N. Y. S. 58 (1913).

[11] In re London's Estate, 104 Misc. 372, 171 N. Y. S. 981, aff'd. 187 App. Div. 952, 175 N. Y. S. 910 (1919); Matter of Olmstead, 52 App. Div. 515 (1900); Matter of Hall, 164 N. Y. 196 (1900); Clark v. Clark, 23 Misc. 272 (1898).

[12] In re Watson, 81 Misc. 89, 142 N. Y. S. 1058 (1913); Seligman v. Seligman, 151 N. Y. S. 889 (1915).

investment will be permitted under such authority.[13] The court will take such steps as may be necessary in cases in which conditions which were not contemplated by the creator of the trust have arisen so that the trust purpose would be defeated by following the directions of the trust instrument.[14]

TERMS OF THE TRUST INSTRUMENT — DISCRETIONARY POWERS.—Since the creator of a trust may include in the trust instrument such directions as he pleases, he may empower the trustee to invest and reinvest the trust fund as he may, in his absolute discretion, deem best, without being hampered by the restrictions of the ordinary rules of law where trustees are not so empowered.[15] But the extent of the discretionary power granted to a trustee is determined by construction of the instrument. It is significant to determine if, under the terms of the instrument, the trustee is granted discretionary power to invest the trust fund. Frequently trust instruments contain provisions giving the trustee authority to invest and reinvest the trust fund "as they shall deem wise and judicious," or "within their discretion," or "for the best interest of the beneficiaries." Such terms have been held not to warrant investment in other than legal securities.[16] Expressions of this sort do not empower the trustee to choose non-legals but merely show the creator's intention to permit the trustee discretion to select investments from the list authorized by law as legal for trust funds.[17] Authority to invest in non-legals must be stated in language which makes it plain that the creator of the trust intended the trustee to have such power.[18] A will stated that "each of the trustees is authorized and empowered in its discretion to continue to hold the investments . . . or to sell the same or any part thereof and to invest and reinvest in any interest-bearing or dividend paying security it shall deem advisable and shall not be restricted to such

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[13] In re Franklin Trust Co., 147 N. Y. S. 885 (1914).

[14] Matter of Pulitzer, 139 Misc. 575, 249 N. Y. S. 87 (1931); Matter of Morris, 63 Hun. 619, 18 N. Y. S. 680, aff'd. 133 N. Y. 693, 31 N. E. 627 (1892); Webster Realty Co. v. Delano 135 App. Div. 488, 120 N. Y. S. 440 (1909); Matter of Frank, 124 Misc. 664 (1925). This question is discussed fully by Scott, Austin W., "Deviation from the Terms of a Trust," *Harvard Law Review,* May, 1931.

[15] In re Maloney's Estate, 120 Misc. 456, 198 N. Y. S. 788 (1923); In re United States Trust Co. of N. Y. 189 App. Div. 75, 178 N. Y. S. 125 (1919); In re Bernheimer's Estate, 106 Misc. 719, 175 N. Y. S. 594 (1919).

[16] Matter of McDowell, 102 Misc. Rep. 275, 169 N. Y. S. 853, aff'd. 193 App. Div. 914, 183 N. Y. S. 952, aff'd., 230 N. Y. 601, 130 N. E. 910 (1921).

[17] In re Robbin's Will, 135 Misc. Rep. 220, 237 N. Y. S. 409 (1929).

[18] *Ibid.;* In re Maloney's Estate, 120 Misc. 456, 198 N. Y. S. 788 (1923); Lawton v. Lawton, 35 App. Div. 389, 54 N. Y. S. 760 (1898).

securities as are usually denominated trustees investments." Pursuant to these terms the trustees invested the trust fund in securities which were non-legals. The court held that the language above granted the trustees the right to invest in non-legal securities as in their judgment may be proper and satisfactory.[19] In the following decisions where the wording of the will was less explicit regarding investing in non-legals the courts held that the terms were sufficiently broad as to authorize trustees to invest in other than legal securities. For example where a will directed that the trust estate "be invested by my said trustee in accordance with their best judgment and discretion" it was held sufficient to authorize investment in non-legals.[20] "To hold in trust . . . and to keep the same invested in such securities as to the said executor shall seem best" permitted the investment of the estate in other than legal securities.[21] However, in the Matter of McDowell[22] the court held that instructions in the instrument to "invest and reinvest all of said trust property as they shall deem wise and judicious for the best interests of the beneficiaries" did not authorize investments in non-legal securities; especially since the testator's investments were superior to those in which the trustee invested.

The trustee is governed only by the rule of good faith when the instrument gives wide discretion as to investments and expressly provides that he shall not be limited to investments "of the character permitted the investments of trust funds by the ordinary rules of law."[23] "If the will implicitly allows investments in other than court securities, the executor may so act, and a reference may be had for his guidance to the securities owned by the testator."[24]

The grant of discretion in the making of investments does not protect the trustee in any investment he may make; the courts have held that he must use good faith and reasonable prudence

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[19] Estate of Elizabeth Chamberlin, N. Y., N. Y. Co. Sur., N. Y. L. J. (1932); Matter of Clark, 257 N. Y. 132, 177 N. E. 397 (1931); In re Leonard's Will, 118 Misc. 598, 193 N. Y. S. 916 (1922).

[20] In re Maloney's Estate, 120 Misc. 456, 198 N. Y. S. 788 (1923).

[21] Lawton v. Lawton, 35 App. Div. 389, 54 N. Y. S. 760 (1898); See also Duncklee v. Butler, 30 Misc. 58 (1899); Matter of Saltau, 118 Misc. 880, 195 N. Y. S. 249 (1922).

[22] 102 Misc. Rep. 275, 169 N. Y. S. 853, aff'd., 193 App. Div. 914, 183 N. Y. S. 952, aff'd., 230 N. Y. 601, 130 N. E. 910 (1921).

[23] Matter of Van Saal, 82 Misc. 531 (1913); Matter of Jarvis, 110 Misc. 5 (1920); Estate of Elizabeth Chamberlin, N. Y., N. Y. Co. Sur. N. Y. L. J. (1932).

[24] In re Leonard's Will, 118 Misc. 598, 193 N. Y. S. 916 (1922). The decision cited Matter of Van Saal's Will, 82 Misc. Rep. 531, 145 N. Y. S. 307 (1913).

in exercising his discretion.[25] The fact that the trustee has absolute and uncontrolled discretionary power does not free him from the fidelity and diligence that attach to his office.[26] The court has the power to review the exercise of discretion and to disapprove improper investments.[27] The court stated its position In re Hall[28] saying: "Surely there is a mean between a government bond and the stock of an Alaska gold mine, and the fact that a trustee is not limited to the one does not authorize him to invest in the other, . . . While, of course, all investments, however carefully made, are more or less liable to depreciate and become worthless, experience has shown that certain classes of investments are peculiarly liable to such depreciation and loss . . . a trustee should, therefore, avoid them, even though he sincerely believes a particular investment of that class to be safe as well as profitable."

INVESTMENT IN LEGALS.—If words in the instrument creating the trust do not either expressly or impliedly give the trustee power to invest in non-legals, trustees are required to invest trust funds in investments sanctioned by law.[29] The investment power of trustees is held to be restricted in view of the fact that the statutes designate the types of securities which are proper investments for trust assets.[30] Any investment not so authorized is a breach of trust and the trustee is liable, unless otherwise directed by the will.[31] In re Randolph[32] the court said: "For many years back, and at present under the statutes of this state, trustees of express trust to hold and invest are permitted, in the absence of express directions to the contrary, to invest the trust funds in bonds and mortgages on unincumbered real property in this state worth 50 per cent more than the amount loaned thereon. But such permission, I think, is always coupled with the implied pro-

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[25] In re Maloney's Estate, 120 Misc. 456, 198 N. Y. S. 788 (1923); In re Hall 164 N. Y. 196, 58 N. E. 11 (1900); Guaranty Trust Co. v. Fisk, N. Y. Sup. Ct., N. Y. L. J. (1934).

[26] Carrier v. Carrier, 226 N. Y. 114, 123 N. E. 135 (1919).

[27] In re Keane, 95 Misc. 25, 160 N. Y. S. 200 (1916).

[28] 164 N. Y. 196, 58 N. E. 11 (1900).

[29] In re King's Estate, 130 Misc. 296, 224 N. Y. S. 283 (1927); Villard v. Villard, 219 N. Y. 482, 114 N. E. 789 (1916); King v. Talbot, 40 N. Y. 76 (1869); In re Leonard's Will, 118 Misc. 598, 193 N. Y. S. 916 (1922); In re Bernheimer's Estate, 106 Misc. 719, 175, N. Y. S. 594 (1919); Matter of Wotton, 59 A. D. 584, 69 N. Y. S. 753, aff'd., 167 N. Y. 629, 60 N. E. 1123 (1901).

[30] Matter of Wotton, 59 App. Div. 584, 69 N. Y. S. 753, aff'd., 167 N. Y. 629, 60 N. E. 1123 (1901).

[31] In re Leonard's Will, 118 Misc. 598, 193 N. Y. S. 916 (1922); In re Saltau's Estate, 118 Misc. 880, 195 N. Y. S. 249 (1922).

[32] 134 N. Y. S. 1117 (1911).

viso that such loan is to be in other respects reasonable and proper. The surrogate does not understand that this qualification, formerly well understood in Courts of Chancery, is abrogated by the statutes of either England or New York regulating pro tanto the investments of trustees. On the contrary, this qualification must be read, as it were, into the statutes." But In re Cady's Estate[33] the court held that a trustee may make certain investments, according to statutory authority, without risk to himself.

INVESTMENTS DURING A DEPRESSION.—During the depression many securities lost their legal status, or were so threatened, while others showed a substantial depreciation. The situation created a problem for the trust institutions of retaining or disposing of these investments. In re Watson's Estate[34] were set forth the principles which should guide a trustee in deciding when to dispose of non-legal investments of the testator, which the trustee was not authorized to retain. The decision reads: "I cannot find in this will an authority to hold these stocks as a permanent investment. I do feel that the trustees should have such time as good sound judgment may require to protect the estate against the sale of sound securities in a market that is of common knowledge depressed.

"There is no advantage to an estate to arbitrarily, even under statute, deplete the estate.

"The trustees are held to a diligent protection of the estate, and such exercise of judgment in the present condition of the market should not be marked arbitrarily by months."

Regarding the retention of the testator's investments another decision said: "The test by which the conduct of the executors must be gauged is not whether or not some one, after the event, will assure the court . . . that the executors, in their estimation, did or did not do the best thing which was possible under the circumstances. It is whether they conscientiously took advantage of the sources of guidance which were reasonably available to them and governed themselves accordingly."[35]

Even though trustees should convert unauthorized securities into legal investments within a reasonable time, they are allowed to use their discretion in the matter, and may not be liable for loss if they retain the investments, while awaiting a favorable

[33] 211 App. Div. 373, 207 N. Y. S. 385, 817 (1925); See In re Keane, 95 Misc. 25, 160 N. Y. S. 200 (1916), and cases cited therein, for additional cases on the subject.

[34] 145 Misc. 425, 261 N. Y. S. 327 (1931).

[35] Matter of McCafferty, N. Y. Kings Co. Sur. N. Y. L. J. (1933).

situation, provided they have employed diligence and prudence.[36] But where the administrator made no effort to dispose of the decedent's stock of a private corporation which later became insolvent he was surcharged. In the words of the court: "Upon the evidence that no effort was made to sell the stock which had some value and later became worthless, the administrator must be surcharged with the value of the stock."[37]

In re Winburn's Will[38] is a case involving losses incurred in the declining markets of 1929 and 1930. The testator held a diversified list of high grade stocks. He released his executors from any duty to sell them but two of the beneficiaries sought to surcharge the trustees for failure to sell. The court held that there had been no negligence and approved the account of the executors. In rendering the decision the court took specific notice of the business depression since October 1929, saying it "has been the worst and most far-reaching in the history of the world." In the course of the opinion the court said: "Cases are found wherein the depreciation of values of seasoned securities are accounted for by a general business depression and, in such instances, the courts have refused to surcharge representatives of the estate. . . .

"There is no need for executors to jettison worth-while stocks during a financial panic. Executors need not wait on the stock market, but may properly be guided by the tests to be applied, which are: What has been the history of the companies during a period of years? Have they paid regular dividends of regular amounts? Have they a proper capital structure? Are they wisely officered? Has a successful business continued over a period of time? Have they achieved a standing in commercial circles? Have they behind them an established dividend record over a period of years? . . . When the executors took over the estate herein, a financial storm had set in—not country-wide but world-wide. And in the exercise of their judgment, they continued to hold the securities for the purpose of passing them on to the trustees. The storm has not yet subsided. There is a strong undercurrent of depression still running. In the face of such conditions, I think it would be unreasonable to hold executors liable for retaining such well seasoned securities in the light of the terms of the will and the intent of the testator. . . . If foresight were generally as good as hindsight, it would be a far

[36] Matter of Weston, 91 N. Y. 502 (1883); Matter of Mercantile Trust Company, 156 App. Div. 224, 141 N. Y. S. 460 (1913).
[37] In re Lichtman's Estate, N. Y. Bronx Co. Sur., N. Y. L. J. (1932).
[38] 140 Misc. 18, 249 N. Y. S. 758 (1931).

more pleasant world in which to live. I wonder if the objectors would have asked for a surcharge if the executors had sold the securities and, within a reasonable time thereafter, the stock market had shown a good advance."[39]

In the falling market of 1920 trustees were surcharged for gross negligence in failing to sell Interborough Rapid Transit securities. The surrogate said: "In my opinion, the trustees, in the exercise of due care, diligence, prudence and active vigilance, should have sold the bonds by the month of June, 1918, when the market had declined to eighty-two and showed every evidence of further decline. In April, 1918, the legislature had adjourned without granting relief to the Interborough Rapid Transit Company, which had asked for an increase of fares. The municipal administration in Greater New York was and is still hostile to the company. It was and is still active in the endeavor to force municipal ownership and operation, creating a change in our theory of government. It sought then and still seeks to act in a manner which will cause the wreck of this property. The end of the war was not in sight.

"With all these depressing and deplorable conditions, careful trustees should have foreseen that a further decline was sure and certain. These trustees should have sold the bonds, taken the actual loss and thereby saved themselves from criticism and liability. They should not have retained them except upon the consent of the beneficiaries. The loss resulted from the retention of the securities. Villard v. Villard (1916), 219 N. Y. 482, 114 N. E. 789. The well-settled rules against laxity of trustees must not be impaired. I do not intend to hold them to a stricter degree of responsibility than ought to be severally required from executors and trustees. I shall surcharge the trustees for a part of the loss sustained by Mrs. Vaughan to the extent of the last ten points of the decline, or $5,000."[40]

TIME ALLOWED FOR CHANGING UNAUTHORIZED INVESTMENTS. —In King v. Talbot[41] the court held, as a general rule, that a trustee should convert non-legal investments into legals within one year. Later the court refused to define what is a reasonable

[39] For rulings on the question see: In re Beadleston's Estate, 146 Misc. 548 (1933); Matter of Pratt, 143 Misc. 751, 257 N. Y. S. 226 (1932); Matter of Chaves, 143 Misc. 868, 257 N. Y. S. 641 (1932); Chemical Bank and Trust Co. v. Reynaud, N. Y. S. Ct., Sp. T. Pt. III N. Y. L. J. (1932); In re Chamberlin's Estate, N. Y., N. Y. Co. Sur., N. Y. L. J. (1932); In re Clark's Will, 257 N. Y. 132, 177 N. E. 397 (1931); In re Wilmerding's Will, 135 Misc. 674, 238, N. Y. S. 375 (1929); Matter of U. S. Trust Co., 189 App. Div. 75, 178 N. Y. S. 125 (1919).

[40] Matter of Jarvis, 110 Misc. 5, 180 N. Y. S. 324 (1920).

[41] 40 N. Y. 76 (1869).

time for retaining non-legal investments of the testator, saying: "This is a question of business judgment for the fiduciary, for the determination of which it is paid, and which it, alone, must decide."[42] Another court ruled that "where no modifying facts are shown to shorten or lengthen the reasonable time, the period of eighteen months may serve as a just standard; although it was also held that while such period furnishes a convenient guide where no special circumstances exist, it must, after all not be taken as a fixed or arbitrary standard. The test must remain, the diligence and prudence of prudent and intelligent men in the management of their own affairs."[43]

PASSIVE TRUSTEESHIP.—The courts not only hold a trustee liable for acting improperly, without due diligence and discretion, but also for not acting at all. The law recognizes no such thing as a passive trustee, hence frequently passive trustees, entirely innocent of any wrong intention, may suddenly be charged with loss for negligence. A recent decision of the Appellate Division of the New York Supreme Court in Brown v. Phelan[44] should be a warning to all passive trustees. A testator died in 1908, leaving an estate of over $1,000,000 in trust. Two sons and one cousin were appointed trustees; two of the trustees remained passive, while the third squandered the estate. A few years later, the two passive trustees were sued for loss and held liable. In answer to the argument that these trustees had no control over the estate, the court ruled that the defendants cannot be relieved from liability by a plea that they were merely passive trustees, having no control or management of the estate. The record clearly negatives any such claim and establishes their gross and inexcusable negligence in permitting the looting of the estate by their co-trustee. They are legally responsible for his act.

A similar opinion was expressed in Adair et al v. Brimmer et al.[45] It is not necessary for the purpose of establishing Mr. Brimmer's liability for these advances to show his express consent to them. "Where an executor by his negligence suffers his co-executor to receive and waste the estate, when he has means to prevent it by proper care, he is liable to beneficiary" under the will for the estate thus wasted.

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[42] In re Stort's Estate, 142 Misc. 54, 253 N. Y. S. 834 (1931), which cited Matter of Wiessman's Estate, 140 Misc. Rep. 360, 363, 250 N. Y. S. 500; Matter of Ebbet's Estate, 139 Misc. 250, 252, 248 N. Y. S. 179; Matter of Wander's Estate, 141 Misc. Rep. 584, 252 N. Y. S. 813.

[43] In re Watson's Estate, 145 Misc. 425, 261 N. Y. S. 327 (1931), citing Matter of Weston, 91 N. Y. 502.

[44] 224 N. Y. S. 391 (1927).

[45] 74 N. Y. 539 (1878).

This point was also emphasized in the Matter of Myers[46] where the court said: "The executors were all properly charged with liability to account for and pay over the income of the trust estate, under the proofs in this case. They all qualified; they all united in causing the inventory to be made; they must all have known of the condition of the estate as disclosed by the inventory; two of them, certainly, had actual knowledge of the use which was made of the property; if the others did not know, they could have known by the exercise of ordinary care and vigilance that the funds had been diverted from the usual course of trust investments and were employed in the business of the new firm."

TRUSTEE'S POWER OF SALE.—The general rule is that trustees may not sell or vary specific securities received in trust unless so authorized (1) by the terms of the trust instrument, either expressly or by implication; or (2) by the court. If the trust instrument expressly empowers the trustee to sell he has full authority to sell the trust assets[47] but he must comply with the terms of the instrument, if any, on the matter.[48] The power to sell may be mandatory[49] and if so the trustee must exercise the power at the time[50] and according to instructions. If the power to sell is discretionary,[51] good faith and the prudence and diligence of a reasonable man is called for. When an absolute power of sale is conferred upon the trustee, the addition of words suggesting a time for its exercise, or indicating the testator's desire in that regard, does not restrain or limit the action of the trustee.[52] Apparently a single exercise of the power to sell by a trustee does not exhaust such an authority unless a permanent reinvestment is contemplated by the trust instrument.[53]

Although the terms of the trust do not empower the trustee to sell, such power will be implied if a sale of trust property is required for the proper execution of the trust purpose.[54]

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[46] 131 N. Y. 409 (1892).

[47] In re Lichtenberg's Estate, 114 Misc. 89, 185 N. Y. S. 913 (1921).

[48] In re Pressprich's Estate, 124 Misc. 15, 207 N. Y. S. 412 (1924); In re Toplitz's Estate, 109 Misc. 401, 179 N. Y. S. 876 (1919), aff'd. 191 App. Div. 477, 181 N. Y. S. 483 (1920).

[49] Simonds v. Rowe, 110 Misc. 52, 180 N. Y. S. 677, aff'd., 195 A. D. 914, 185 N. Y. S. 954 (1920).

[50] Fraser v. Bowerman, 104 Misc. 260, aff'd., 187 A. D. 926, 174 N. Y. S. 903 (1918).

[51] In re Pressprich's Estate, 124 Misc. 15, 207 N. Y. S. 412 (1924).

[52] *Ibid.* This decision cited many other cases on this point.

[53] Hatt v. Hagaman, 12 Misc, 171, 33 N. Y. S. 5 (1895).

[54] In re George's Executors, 120 Misc. 171, 197 N. Y. S. 716, (1923); Burnham v. White, 117 A. D. 515, 102 N. Y. S. 717 (1907); Mertz v. Guaranty Trust Co. of N. Y., 247 N. Y. 137, 159 N. E. 888 (1928).

If the trustee is not empowered to sell trust property by the trust instrument, he may be authorized by a court of equity to do so[55] when an exigency arises which was not contemplated by the testator,[56] when the income from the trust property is less than was expected by the creator,[57] or when the estate has become virtually unproductive.[58]

"While . . . the general rule is . . . 'that trustees may not sell or vary specific securities given in trust, nor securities left by a testator, in which he has himself invested the funds' . . . this rule does not prevent trustees from converting wasting securities into those of a permanent character, and converting investments, that are not authorized by law, into such as are allowed by law."[59]

EXEMPTION.—The grantor has full authority to prescribe the duties of a trustee regarding the investment of trust funds. Such a power includes the right to exempt the trustee from liability for loss or depreciation. If the instrument clearly embodies such provisions they are effective in the absence of bad faith.[60]

A will provided that the trustee should not be liable for any loss unless due to actual fraud. Although the trustee's administration showed negligence, carelessness and lack of prudence, he was not liable because actual fraud was not proved.[61] In re Olmstead[62] where the trustees were exempted from liability for loss unless due to gross neglect, they were held liable. The court ruled that such a provision did not exempt the trustees for authorizing the receipt of the proceeds of a life insurance policy by a third person on a mere promise to apply the money in repairing the damaged property. In another case the trustees were given wide discretion and were not to be held liable for loss so long as they exercise sound judgment and act in good faith. But the trustees were liable for not selling the investments on a declining market when it was clearly evident that proper attention would have shown that losses were inevitable if the securities were retained.[63]

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[55] In re Roscoe's Will, 127 Misc. 773, 216 N. Y. S. 620 (1926); Matter of Asch, 75 A. D. 486, 78 N. Y. S. 561 (1902); In re Mills, 28 A. D. 258, 50 N. Y. S. 995 (1898).

[56] Matter of Pulitzer, 139 Misc. 575, 249 N. Y. S. 87 (1931).

[57] Matter of Morris, 63 Hun. 619, 18 N. Y. S. 680, aff'd., 13 N. Y. 693, 31 N. E. 627 (1892).

[58] Webster Realty Co. v. Delano, 135 App. Div. 488, 120 N. Y. S. 440 (1909).

[59] In re Quinby's Will, 134 Misc. 296, 235 N. Y. S. 308 (1929).

[60] Gould v. Gould, 126 Misc. 54, 213 N. Y. S. 286 (1925); In re Clark's Will, 257 N. Y. 132 (1931); In re Fulton Trust Co., 257 N. Y. 132 (1931).

[61] In re Knower's Estate, 121 Misc. 208, 200 N. Y. S. 777 (1923).

[62] 52 App. Div. 515, 66 N. Y. S. 212 (1900).

[63] In re Jarvis' Estate, 110 Misc. 5, 180 N. Y. S. 324 (1920).

Where the trustees were "chargeable only with the exercise of reasonable care and diligence and neither of them shall be liable for any mistakes of judgment" the court ruled that such discretionary investment powers did not entitle the trustees to purchase the stock of a new corporation, for it would mean "leaving the field of investment and entering the domain of speculation." Thus, the trustees were not exempted. The court decreed that the purchase of stock under such conditions was a breach of trust.[64]

It is clear that the New York Courts construe immunity clauses strictly and that trustees are held to the common duties of their position.[65]

CONTINUING INVESTMENTS RECEIVED FROM THE GRANTOR.—It is a well settled rule in New York that a trustee may retain such investments of the creator of the trust as are legal for trust funds or he may retain non-legal investments if authorized by the trust instrument.[66] When a trustee assumes a trust, if he finds the fund invested in non-legals, it is his duty, unless empowered by the trust instrument to the contrary, to convert them into authorized investments.[67] Otherwise retention becomes an affirmative act of adoption, equivalent to making an investment in unauthorized securities.[68] "When a trustee finds the estate committed to him already invested in interest-bearing securities, we are not inclined to say that it is his absolute duty at once to dispose of them, without regard to the market, or the demand for them, or the ruling price, or the probability of an advance in their value. It is sufficient to say, however, that, ordinarily, if a trustee sees fit to continue such investments after he shall have had a reasonable opportunity to sell them without loss and to invest them in those securities which by law he is authorized

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[64] Guaranty Trust Co. of N. Y. v. Fisk, N. Y. Sup. Ct., N. Y. L. J. (Feb. 28, 1934).

[65] Adair v. Brimmer, 74 N. Y. 539 (1878); In re Olmstead, 52 App. Div. 515, 66 N. Y. S. 212 (1900); In re Jarvis' Estate, 110 Misc. 5, 180 N. Y. S. 324 (1920).

[66] In re Winburn's Will, 140 Misc. Rep. 18, 249 N. Y. S. 758 (1931); In re Wilmerding's Will, 135 Misc. Rep. 674, 238 N. Y. S. 375 (1929); In re Channing's Estate, 129 Misc. Rep. 393, 222 N. Y. S. 351 (1927); In re Leonard's Will, 118 Misc. Rep. 598, 193 N. Y. S. 916 (1922); In re Bernheimer's Estate, 106, Misc. Rep. 719, 175 N. Y. S. 594 (1919).

[67] In re King's Estate, 130 Misc. 296, 224 N. Y. S. 283 (1927); In re Soltau's Estate, 118 Misc. 880, 195 N. Y. S. 249 (1922); In re Hirsch's Estate, 116 App. Div. 367, 101 N. Y. S. 893, aff'd., 188 N. Y. 584 (1906); Matter of Myers, 131 N. Y. 409, 30 N. E. 135 (1892); In re Weston's Estate, 91 N. Y. 502 (1883).

[68] Matter of Hirsch's Estate, 116 App. Div. 367, aff'd., 188 N. Y. 584 (1906); Matter of Myers, 131 N. Y. 409 (1892).

to hold, it must be an exceptional case which will justify him in his failure to do so, where as a result of that failure there has been a loss."[69] In general, trustees should follow the same rules in retaining investments as in the making of original investments. A New York court has declared, however, that in retaining investments received from the creator of the trust, even if they should not be continued under the terms of the state law, the trustee is not governed by the same strict rules of liability to which they are held in making original investments.[70]

For the most part the courts of New York have been inclined to be liberal in construing the provisions of the trust instrument to allow trustees to continue other than strictly legal securities. Where wills contained such directions as to keep the estate "invested in such securities as to the said executor shall deem best," or that the trust principal is "to be invested by my said trustees in accordance with their best judgment and discretion," or that the trustee shall keep the estate "invested in good, sound dividend-paying securities," have been held sufficient to authorize the trustee in retaining investments made by the testator.[71]

Under one will, a trustee was authorized to receive securities and to hold them under trust, with a further provision that the trustee was not to be held liable for any loss resulting from retention of securities, or by reason of any investments made in accordance with directions. The trustee held, among other securities, certain shares of the Chicago, Milwaukee and St. Paul Railroad for thirteen years, and then sold them at a loss. The court, however, decided that this was not negligence on the trustee's part, and that "it would be unreasonable to hold a trustee liable for retaining such securities under such conditions in the hope of a better market, when it was authorized by the terms of the trust to make such an investment originally."[72]

When reasonable and warranted, New York courts tend to sanction the retention of the grantor's investments, even though the trust instrument does not specify their continuance.[73]

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[69] In re Wotton, 59 App. Div. 584, 69 N. Y. S. 753 (1901).

[70] Jones v. Jones, 50 Hun. 603, 2 N. Y. S. 844 (1888); Wotton v. De Reau, 59 App. Div. 584, 69 N. Y. S. 753 (1901).

[71] In re Maloney's Estate, 120 Misc. 456, 198 N. Y. S. 788 (1923); Lawton v. Lawton, 35 App. Div. 389, 54 N. Y. S. 760 (1898); In re Leonard's Will, 118 Misc. 598, 193 N. Y. S. 916 (1922); Duncklee v. Butler, 30 Misc. 58 (1899).

[72] Matter of United States Trust Co., 189 App. Div. 75 (1919).

[73] Matter of McCafferty, N. Y., Kings Co. Sur. N. Y. L. J. (1933); Matter of Pratt, 143 Misc. 751, 257 N. Y. S. 226 (1932); Matter of Pulsifier's Estate, N. Y., N. Y. Co. Sur., N. Y. L. J. (1932); Estate of Virginia Tryon Kent, 261 N. Y. S. 698 (1932).

If a trustee "continues non-legal investments and a loss occurs he must justify his acts by proof of circumstances over which he had no control, or by proof that under the circumstances existing he has acted as 'in general, prudent men of discretion and intelligence' would have acted."[74] General powers to retain do not free the trustee in retaining non-legals in all circumstances.[75] Protection is given only if the trustee uses sound discretion as well as the care and prudence of a reasonable man dealing with his own funds.[76]

RETAINING AUTHORIZED SECURITIES WHICH SUBSEQUENTLY CHANGE IN FORM.—The grantor's investments which are authorized to be retained, should be disposed of if through a subsequent change in form they cease to be the type of security originally authorized to be retained.[77] A trustee was authorized to retain stock in which the grantor had invested but new investments were to be made in "legals." The grantor had invested in stock of the Standard Oil Company so when the company was split up by a court decree, the trustee received stock of the various subsidiary companies. The court ruled that the terms of the will did not justify the retaining of stocks in their new form.[78] A New York court ruled that it is "a question of fact as to whether the new securities which have come into the hands of the trustee in substitution for those received from the testator are merely the securities of the same corporation under another name or whether they are those of distinctly different or materially altered businesses."[79]

STOCK RIGHTS.—Unless authorized by the trust instrument trustees may not exercise stock rights to subscribe to stocks where such rights are issued upon stocks held in trust.[80] Where trustees were authorized by a will to retain stocks purchased by the testator, it was held that "authority to exercise rights to subscribe must be deemed to be incidental and appurtenant to the original

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[74] In re Parson's Estate, 143 Misc. 368, 257 N. Y. S. 339 (1932); In re Sprong's Estate, 144 Misc. 293, 259 N. Y. S. 77 (1932); Matter of McCafferty, N. Y., Kings Co. Sur., N. Y. L. J. (1933); Costello v. Costello, 209 N. Y. 252, 103 N. E. 148 (1913).

[75] In re Channing's Estate, 129 Misc. Rep. 393, 222 N. Y. S. 351 (1927).

[76] In re Wilmerding's Will, 135 Misc. Rep. 674, 238 N. Y. S. 375 (1929); In re Channing's Estate, 129 Misc. Rep. 222 N. Y. S. 351 (1927); Chemical Bank and Trust Co v. Raynoud, N. Y. S. Ct., Sp. Tt. Pt. III N. Y. L. J. (1932); In re Pratt's Estate, 143 Misc. 751, 257 N. Y. S. 226 (1932).

[77] Mertz v. Guaranty Trust Co., 247 N. Y. 137, 159 N. E. 888 (1928); In re Franklin Tr. Co., 84 Misc. 686, 147 N. Y. S. 885 (1914); In re Bannin, 142 App. Div. 436, 127 N. Y. S. 92 (1911).

[78] In re Franklin Trust Co., 84 Misc. 686, 147 N. Y. S. 885 (1914).

[79] In re Harriman's Estate, N. Y. Sur., N. Y. L. J. (1931).

[80] In re Davison's Executors, 134 Misc. 769, 236 N. Y. S. 437, (1929).

grant of authority to the trustees."[81] A will authorized the retention of New York Central Railroad stock but stated that "any investment or reinvestment of any funds . . . shall be made only in such classes of investment as an executor or trustee is alone allowed by law to make." Trustee purchased stock rights of New York Central Railroad and subscribed to the stock but the court held that such action was unauthorized.[82]

CONTINUING THE GRANTOR'S BUSINESS.—In the absence of power to carry on the grantor's business, it is the trustee's duty to close up the trade, to withdraw the trust fund, and to invest it in the proper securities as soon as possible. The reason is that the hazards of trade and business are too great to render such operations proper for trustees.[83] The rule is clear in New York that the business of the grantor may not be continued by the trustee unless he is expressly so empowered.[84] Although the grantor may authorize or direct the continuance of his business "the intention of a testator to confer upon an executor power to continue a trade must be found in the direct, explicit and unequivocal language of the will or else it will not be deemed to have been conferred."[85] If the trustee is granted such a power he is authorized to conduct "the business in the usual manner unless otherwise expressly directed or limited."[86] Such powers apply only to the individual business of the grantor and not to corporations in which he had stock investments.[87]

There are times, however, when it is necessary to carry on a business, or to complete the production of goods in process, or to create liabilities, or to carry out contracts, all being clearly for the best interests of the estate. If such a course is necessary the trustee will be permitted this latitude.[88] Undoubtedly, even in these cases, it would be advisable for the trustee to secure a court order as a matter of self protection.

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[81] In re Vanderbilt's Estate, 132 Misc. 150, 229 N. Y. S. 631, (1928).

[82] In re Blake's Estate, N. Y. Kings Co. Sur., N. Y. L. J. (1933).

[83] See In re Gorra's Estate, 135 Misc. 93, 236 N. Y. S. 709 (1929) for rules regarding continuing grantor's business; Willis v. Sharp, 113 N. Y. 586 (1889); Matter of Myers, 131 N. Y. 409 (1892); Warren v. Union Bank, 157 N. Y. 259 (1898); Matter of McCollum, 80 App. Div. 362 (1903); Matter of Kohler, 231 N. Y. 353 (1921).

[84] *Supra*, n. 83.

[85] In re Gorra's Estate, *supra*, n. 83; Willis v. Sharp, *supra*, n. 83; Matter of Kohler, *supra*, n. 83; Miller v. King, 166 N. Y. 394, aff'd., 168 N. Y. 635 (1901).

[86] In re Gorra's Estate, *supra*, n. 83; Matter of Kohler, *supra*, n. 83.

[87] *Supra*, n. 86.

[88] Pitts v. Jamison, 15 Barb (N. Y.) 310 (1853); Cornwell v. Deck, 2 Redf. (N. Y.) 87 (1874).

TAKING OVER INVESTMENTS FROM PREDECESSOR TRUSTEE.—The necessity for extreme care on the part of a succeeding trustee is shown in Villard v. Villard.[89] By the trust instrument the executors and trustees were authorized to retain any investments made by the testator. The executors made various changes in the list of investments, including the purchase of some common stock of the Baltimore and Ohio Railroad, which was not legal. At the time the succeeding trustee accepted them, it supposed such securities had been owned by the testator, and consequently made no effort to investigate. In the meantime the stock depreciated in value. The court held the trustee liable for the loss resulting from the depreciated stock, stating: "The trustee at the time of delivery to and acceptance by it of said shares . . . by the exercise of ordinary care, could have known that neither said stocks nor either of them were owned by the testator at his death. An inquiry would have been a simple act of prudence required by the measure of care owed by the trustee in the discharge of its duties." If a trustee accepts investments chosen by his predecessor, which are not legal, he should convert them into securities proper for trust funds.[90]

The trust instrument empowered the trustee "to hold and retain at his discretion any and all of the securities and other property . . . said trustee shall not in making investments and reinvestments . . . be limited to the investments authorized by law, and I hereby give him full and complete power and authority to invest . . ." The court said: "I hold that the language above quoted grants to the trustee the power to retain or reinvest the funds of the estate in non-legal securities as in their judgment may be proper and satisfactory (Matter of Clark, 257 N. Y. 132). Such power conferred upon the original trustee as to investments may be exercised by the substituted trustees."[91]

If a trustee is compelled by a court to take over from his predecessor securities of doubtful value which may have no market, he is required merely to show good faith in handling them and will not be held liable for loss if he uses his best judgment.[92]

BANK DEPOSITS.—The law allows the trustee to deposit the trust funds in a bank for some time after their receipt, to enable

[89] 219 N. Y. 482, 114 N. E. 789 (1916).

[90] In re Yung's Estate, 103 Misc. 358, 170 N. Y. S. 303 (1918); Villard v. Villard, 219 N. Y. 482, 114 N. E. 789 (1916); In re Douglas, 60 App. Div. 64, 69 N. Y. S. 687 (1901).

[91] In re Theband's Estate, N. Y., N. Y. Co. Sur., N. Y. L. J. (1932).

[92] Matter of Sherman, 180 A. D. 196 (1917).

the trustee to find a proper investment.[93] The courts, however, have held that trust funds may not be kept on deposit in a bank for a longer period than is reasonable while a proper investment is being obtained. In this regard a New York Court has said that "the deposit may be continued for so long a period as will enable the trustee, in the use of ordinary diligence, to obtain its secure and proper investment, or the exigencies of the estate may require. But where he fails by his neglect within a reasonable time to secure investments, and allows the money still to remain on deposit, and it is thereby lost, the law charges the trustee with the loss."[94] Deposits for two years[95] and ten years[96] have been held to be unreasonably long, thereby rendering the trustee liable. What constitutes a reasonable time is a question to be decided upon the circumstances of each case.

Although the trustee is permitted to keep funds on deposit in a bank he should not place them on time deposit. A time deposit is an unsecured loan and is not proper. Further, the assets should be immediately available at the call of the trustee.[97] It is permissible to deposit a small fund in a savings bank.[98]

Deposit of trust funds should be made in the name of the trustee as such and not on his behalf individually.[99]

MORTGAGES.—First mortgages on real estate with a sufficient margin of valuation have long been recognized as proper investments for trustees by New York statutes,[100] although there seems to be no definite court ruling on this point. Second mortgages are not proper investments; they are clearly prohibited by the wording of the statute, namely, that investments shall be made in mortgages upon unincumbered real property. This is the accepted rule laid down by New York Courts.[101] In rare cases, however, an investment secured by a second mortgage may be sanctioned by equity, but only when the security is ade-

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[93] New York Banking Law, (1917) Sec. 188 (7) permitted deposit of such funds awaiting investment or distribution.

[94] In re Knight's Estate, 4 N. Y. S. 412 (1888); Matter of Wotton, 59 App. Div. 584, aff'd., 167 N. Y. 629 (1901).

[95] *Ibid.*

[96] In re Donahue, 88 Misc. 359, 151 N. Y. S. 1094 (1914).

[97] Baskin v. Baskin, 4 Lans, (N. Y.) 90 (1871).

[98] In re Wiley, 98 App. Div. 93 (1904).

[99] *Supra,* ns. 97 and 98.

[100] New York Personal Property Law, Sec. 21; N. Y. Banking Law, Sec. 239.

[101] National Surety Co. v. Manhattan Mtg. Co., 185 A. D. 733, 174 N. Y. S. 9, (1919); In re Sherman, 180 A. D. 196, 167 N. Y. S. 682 (1917); In re Petrie, 5 Dem. Sur. N. Y. 352 (1886); Whitney v. Martine, 88 N. Y. 535 (1882); King v. Mackellar, 109 N. Y. 215, 16 N. E. 201 (1888).

quate, and unusual circumstances justify the trustee in making this form of investment.[102]

MORTGAGE PARTICIPATION CERTIFICATES.—Such certificates are legal investments by statute[103] and they have been sanctioned by the courts.[104] "Whether a participation in bond and mortgage is a legal investment for trust funds depends solely upon whether it meets with the requirements of the statutes. . . . It is clear that the Legislature intended the bond and mortgage to be the primary security, and the guaranty, if any, secondary. To render a participation in bond and mortgage legal, . . . it is not necessary that there be a guaranty of payment."[105]

A participating certificate which contained the following clause was held not to be a legal investment. "The corporation upon the consent of the Guarantor, may at any time waive or modify any condition or provision contained in said bond and mortgage and extend or waive the payment of any instalment of principal under the terms of said bond and mortgage, provided that the Guarantor shall not be released in any event from paying this certificate in accordance with the terms thereof."[106]

CORPORATE STOCKS AND BONDS.—Unless specifically authorized by the statute, or by the trust instrument, a trustee in New York may not invest trust funds in corporate stocks and bonds.[107] The best known opinion regarding corporate stocks was set forth by the New York Courts in the famous case of King v. Talbot,[108] where the propriety of investments in stocks was questioned. On this point the court said: "It is not denied that the employment of the fund as capital in trade would be a clear departure

[102] Matter of Blauvelt, 20 N. Y. S. 119, aff'd., 60 Hun. 394 (1891).

[103] New York Personal Property Law, Sec. 21.

[104] In re Thomson's Estate, 135 Misc. 62, 237, N. Y. S. 622 (1929); In re Union Trust Co., 219 N. Y. 514, 114 N. E. 1057 (1916); Estate of Alexander Fraser, N. Y. N. Y. Co. Sur., N. Y. L. J. (1933).

[105] In re Allen, 142 Misc. 113, 254 N. Y. S. 176 (1931).

[106] *Ibid.*

[107] In re Cady's Estate, 211 App. Div. 373, 207 N. Y. S. 385 (1925); Matter of Hall, 164 N. Y. 196, 58 N. E. 11 (1900); Judd v. Warner, 2 Dem. Sur. 104 (1883); In re Keteltas' Estate, Sur. 6 N. Y. S. 668 (1889); the statutes of New York allow trustees to invest in the bonds of certain approved companies which meet specified financial tests.

[108] 40 N. Y. 76, 88, 89—Other leading cases concerning the legality of a trust investment in corporate stock are the following: Hogan v. De Peyster, 20 Barb. 100; Mills v. Hoffman, 26 Hun. 594; Matter of Wotton, 59 A. D. 584; Matter of Douglas, 60 A. D. 64; Matter of Hall, 164 N. Y. 196; Adair v. Brimmer, 74 N. Y. 539; In Costello v. Costello, 209 N. Y. 252, it was held that although the statutory and court rules in the state generally deny the trustees right to invest in stock, yet they do not invariably make such an investment illegal. The trustees in this case were authorized to accept corporate stock in exchange for an interest in a partnership.

from the duty of trustees. If it cannot be so employed under the management of a co-partnership, I see no reason for saying that the incorporation of the partners tends, in any degree to justify it. The moment the fund is invested in bank, or insurance, or railroad stock, it has left the control of the trustees; its safety, and the hazard or risk of loss, is no longer dependent upon their skill, care, or discretion, in its custody or management, and the terms of the investment do not contemplate that it will ever be returned to the trustees. If it be said, that, at any time, the trustees may sell the stock . . . and so repossess themselves of the original capital, I reply, that is necessarily contingent and uncertain; and so the fund has been voluntarily placed in a condition of uncertainty, dependent upon two contingencies: First, the practicability of making the business profitable; and, second, the judgment, skill, and fidelity of those, who have the management of it for that purpose."

If the terms of the trust instrument permit such investments, or give the trustee broad powers of investment, trust funds may be invested in corporate stock, provided the trustee uses due care and diligence.[109]

If it is necessary to purchase corporate stocks or bonds for the protection of the estate, the trustee will not be held liable for so doing.[110]

PROMISSORY NOTE.—Promissory notes frequently form part of the trust principal, being received from the grantor or from a predecessor trustee. Few types of investment create greater responsibility for the trustee. In the administration of this form of investment the trustee should follow carefully the instructions in the instrument of trust. Personal securities received in trust which are not legal should be converted into proper investments. It is a rule in New York that a trustee may not invest trust funds upon personal property unless specifically authorized so to do by the trust instrument.[111] If a trustee makes a loan upon mere personal security he will be liable for whatever losses result to the estate.[112] If a trustee is granted broad discretion over investments it is not prudent to invest in personal securities. The

[109] In re United States Trust Co. of N. Y. 189 A. D. 75, 178 N. Y. S. 125 (1919); See Guaranty Trust Co. v. Fisk, N. Y. Sup. Ct., N. Y. L. J. (1934).

[110] In re Vanderbilt's Estate, 132 Misc. 150, 229 N. Y. S. 631 (1928).

[111] Matter of Krisfeldt, 49 Misc. 26, 97 N. Y. S. 877 (1905); King v. Talbot, 40 N. Y. 76 (1869); In re Foster's Will, 15 Hun. 387 (1878); In re Petrie, 5 Dem. Sur. 352 (1886); In re Randolph, 134 N. Y. S. 1117, aff'd., 150 App. Div. 902, 135 N. Y. S. 1138 (1912); Wilmerding v. McKesson, 103 N. Y. 329, 8 N. E. 665 (1886); Deabold v. Oppermann, 111 N. Y. 531, 19 N. E. 94 (1888).

[112] *Ibid.*

courts do not deem that personal sureties are sufficient security for a trust investment. It is felt that trust investments should contain a lien upon or interest in property having an intrinsic value sufficient to secure the safety of the investment. The value of a promissory note depends upon uncertain contingencies.

If a trustee invests in promissory notes which are adequately secured by collateral, such investments may be satisfactory. The collateral, however, should be instruments which are in themselves legal investments and the margin of safety should be ample.

In Hodgman v. Cobb[113] it was ruled that a loan to a contingent remainderman was not a legal investment authorized by law. Executors of a sole stockholder should not loan the estate funds to the corporation.[114]

Sums due the testator should not be permitted to remain on deposit with, or as a loan to, a debtor. Under the Decedent Estate Law, Section 111, such amounts are not authorized as legal investments.[115]

REAL ESTATE.—Trustees should not, except under unusual circumstances, invest trust funds in the purchase of real estate.[116] An investment in real estate is improper unless authorized by the trust instrument.[117] Trustees who, without authority in the will, deal in real estate, are liable for losses. A trustee should not place the trust assets in a leasehold estate in real property.[118] If a trustee without authority from the trust instrument, forms a real estate corporation for the holding or handling of securities or to take over the trust estate, he is liable for losses.[119] In Schummers' Will[120] it was ruled that where the trust instrument does not clearly authorize the investment of the trust assets in land, the law will not permit such investments by executors and trustees.

The trustee may purchase real estate if such a step is necessary in order to protect the estate. Likewise, the acquisition of realty through the foreclosure of a mortgage which is held by the trust estate is sanctioned to protect the trust interest.

TRADE OR BUSINESS.—The investment of trust funds in trade or business is clearly prohibited unless the terms of the trust

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113 202 App. Div. 259, 195 N. Y. S. 428 (1922).
114 East Side Packing Co. v. Fahy Market, 24 F (2d) 644 (1928).
115 In re Keane, 95 Misc. 25, 160 N. Y. S. 200 (1916).
116 Baker v. Disbrow, 3 Redf. 348; Aff'd., 18 Hun. N. Y. 29 (1879).
117 Matter of Trelease, 49 Misc. 205, 96 N. Y. S. 318, aff'd., 115 App. Div. 654, 100 N. Y. S. 1051 (1906).
118 In re Anderson, 211 N. Y. 136 (1914).
119 Matter of Lyall, 212 A. D. 417, 208, N. Y. S. 529 (1925).
120 210 App. Div. 296, 206 N. Y. S. 113 (1924).

instrument empower the trustee to do so.[121] The legal principles governing such cases have been clearly set forth in the decisions of New York courts. The investment of trust assets in a trade or in a business, without specific authorization, is a breach of trust. If a trustee employs the trust principal in such a manner he will be compelled to stand all losses and to turn over all profits.[122] The employment of the trust estate in business is not considered sound discretion. It is deemed too speculative and the risks of loss too great.

INVESTMENTS OF A SPECULATIVE OR UNTRIED NATURE.—New York courts severely condemn investments of a speculative or untried nature.[123] In re Cady's Estate[124] the court said that "under no pretext whatever may trust funds be used for engaging in wild speculation. To so use them is illegal, and constitutes a *devastavit,* and the funds may be reclaimed not only from the trustee, but from any one receiving them with notice." Speculations as such are "beyond the powers of legal representatives to indulge in."[125] The purchase of stock on the margin is not a proper investment.[126]

INVESTMENTS IN OTHER STATES.—In considering the validity of an investment in another state, one New York court has well stated the general rule on this subject:[127] "While therefore we are not disposed to say that an investment by a trustee in another state can never be consistent with the prudence and diligence required of him by law, we still feel bound to say that such an investment which takes the trust fund, beyond our jurisdiction, subjects it to other laws and the risks and inconveniences of distance and foreign tribunals, will not be upheld by us as a

[121] In re Hurlbut's Executors, 210 App. Div. 456, 206 N. Y. S. 448 (1924); In re Lyall's Will, 212 App. Div. 417, 208 N. Y. S. 529 (1925); Warren v. Rochester Union Bank, 157 N. Y. 259, 51 N. E. 1036 (1898); In re Hall, 164 N. Y. 196, 58 N. E. 11 (1900); Willis v. Sharp, 113 N. Y. 586, 21 N. E. 705 (1889); In re Gorra's Estate, 135 Misc. 93, 236 N. Y. S. 709 (1929).

[122] *Supra,* n. 121.

[123] Guaranty Trust Co. v. Fisk, N. Y. Sup. Ct., N. Y. L. J. (1934); Gould v. Gould, 126 Misc. 54, 213 N. Y. S. 286 (1926); Scandinavian Import-Export Co. v. Bachman, 195 App. Div. 297, 186 N. Y. S. 860 (1921); Steel v. Leapold, 135 App. Div. 247, 120 N. Y. S. 569 (1909); Moore v. American Loan and Trust Co., 115 N. Y. 65, 21 N. E. 681 (1889); Deabold v. Opperman, 111 N. Y. 531, 19 N. E. 94 (1888); King v. Talbot, 40 N. Y. 76 (1869); In re Hall, 164 N. Y. 196, 58 N. E. 11 (1900).

[124] 211 App. Div. 373, 207 N. Y. S. 385 (1925).

[125] Matter of Disbrow, 145 Misc. 584, 261 N. Y. S. 635 (1932).

[126] Steel v. Leopold, 135 App. Div. 247, 120 N. Y. S. 569 (1909); Matter of Disbrow, 145 Misc. 584, 261 N. Y. S. 635 (1932).

[127] Ormiston v. Olcott, 84 N. Y. 339 (1881); see also Matter of Reed 45 A. D. 196 (1899).

general rule and never unless in the presence of a clear and strong necessity."

In Denton v. Sanford[128] the court sanctioned an investment in a first mortgage on foreign real estate as being justified from the circumstances. If the trust instrument grants the trustee authority to make other than legal investments, he may invest in mortgages on real property situated in another state, provided he uses proper care and good faith.[129]

The rule regarding investments in another state does not apply to government, railroad, and utility bonds which are authorized by statute.

MATURITY OF INVESTMENTS.—In re Blake's Estate[130] the will directed the trustee to accumulate income of the trust fund and to pay the principal and accumulations to beneficiary on her becoming of age in 1932. The trustee had invested a large proportion of the trust fund in mortgage participation certificates, legal for trust funds, maturing in 1935. The court held that such investments were not readily convertible into cash without danger of sacrifice, consequently to select such investments, maturing after the termination of the trust, which had a definite period to run, was improper.

Part of the estate was invested in bonds which were listed on the stock exchange but they were held to be suitable irrespective of the maturity date. Commenting upon the two types of investments the court said: "Whereas . . . the maturity of these bonds postdated by considerable periods the time when the beneficiary was entitled to receive payment of the accumulated income in cash, they were securities of an entirely different nature from the shares in the private mortgages hereinbefore considered. For securities of this type, a ready open market is maintained which enables a holder to realize upon them without difficulty or sacrifice of their intrinsic value. . . . In participations in mortgages, on the other hand, it is a matter of common knowledge that the market is almost wholly confined to the particular concerns by which such securities are issued, with the result that if the latter so elect, their saleability may be either wholly destroyed or the price depressed out of proportion to intrinsic value." Thus, they were not capable of the ready liquidation which would be required to enable the trustee to meet his obligations to the *cestui que trust* on the specified date. The bonds, however, were capable of the necessary ready liquidation.

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[128] 103 N. Y. 607 (1886).
[129] In re Pollock's Will, 134 Misc. 212, 236 N. Y. S. 149 (1929).
[130] N. Y. Sur., N. Y. L. J. (1933).

INVESTMENTS IN NAME OF TRUSTEE.—Registering investments in the name of the nominee is not sanctioned by the court, which said: "This is a practice which, although prevalent among trust companies in this city, is to be condemned. All securities held by a trustee should be registered in the name of the trustee as trustee under the particular trust. Otherwise a trustee could exhibit the same securities held by it under other trusts. Furthermore, consider the confusion if a member of a firm acting as nominee of the trust company should go into bankruptcy."[131] The court was against permitting provisions to be inserted in a deed of trust authorizing such a practice.

It is a well established rule in New York that trust funds should be invested in the name of the trustee as such[132] and not in his name individually. If they are kept in the name of the trust they can be identified and followed by all interested parties.[133] It is a breach of trust for which he will be held liable if a trustee takes title to the property in his own name, individually.[134]

CONSENT OF BENEFICIARIES.—If the trustee makes or retains investments at the direction or with the consent of the beneficiary, and the latter has full knowledge of the transaction and of his rights, the trustee will not be liable for losses ensuing as a result of such investments.[135] Further, if the beneficiaries acquiesce or ratify the non-legal investment they are estopped from holding the trustee liable for losses incurred thereon.[136]

Beneficiaries have the right to affirm or disaffirm unauthorized investments, but if they elect they are bound by the decision.[137] If beneficiaries accept securities on a distribution they are barred from objecting to them as improper investments.[138]

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[131] City Bank Farmers Trust Co., et. al. v. Burton, et. al. N. Y. S. Ct. N. Y. L. J. (1932); see also Estate of Thomas B. McManus, N. Y., N. Y. Co. Sur., N. Y. L. J. (1932).

[132] In re Union Trust Co., 219 N. Y. 514, 114 N. E. 1057 (1916).

[133] *Ibid.*

[134] In re Boies' Estate, N. Y. Sur., N. Y. L. J. (1931).

[135] Matter of Kent, 261, N. Y. S. 698 (1932); In re Packard's Estate, 261 N. Y. S. 580 (1932); In re Sprong's Estate, 144 Misc. 293, 259 N. Y. S. 77 (1932); Matter of Disbrow, 145 Misc 584, 261 N. Y. S. 635 (1932); Furniss v. Zimmerman, 90 Misc. 138, 154 N. Y. S. 272 (1915); In re Westerfield, 48 App. Div. 542, 63 N. Y. S. 10 (1900); Matter of Hall, 164 N. Y. 196, 58 N. E. 11 (1900); In re Reed, 45 App. Div. 196, 61 N. Y. S. 50 (1899); Adair v. Brimmer, 74 N. Y. 539 (1878); Villard v. Villard, 219 N. Y. 482, 114 N. E. 789 (1916); In re Keane, 97 Misc. 213, 162 N. Y. S. 856 (1916).

[136] *Ibid.*

[137] Hine v. Hine, 118 App. Div. 585 (1907).

[138] In re Kent, 173 App. Div. 563, 159 N. Y. S. 627 (1916).

IMPROPER INVESTMENTS—LIABILITY FOR LOSS.—If a trustee makes an unauthorized investment he will be required to make good any loss resulting to the estate as a result of his improper conduct. However, the estate is entitled only to the damage which has occurred; loss to the estate is the only basis of a surcharge.[139] If the court surcharges the trustee for loss sustained upon his investments, the trustee is entitled to the securities,[140] subject to the beneficiaries' lien thereon, as part of his assets out of which he is chargeable to make good the loss.

When a trustee violated an instruction in the trust instrument to invest in certain securities or to lend upon unincumbered and productive real estate worth at least twice as much as the loan, and accepted a mortgage on unproductive property worth less than the amount of the loan, he was removed.[141] An improper investment, however, is not necessarily ground for the removal of a trustee.[142]

[139] Matter of McCafferty, N. Y. Kings Co. Sur., N. Y. L. J. (1933).

[140] Matter of Lyall, 212 App. Div. 417, 208 N. Y. S. 529 (1925); Matter of Ryer, 94 App. Div. 449, aff'd., 180 N. Y. 532 (1905); Matter of Niles, 113 N. Y. 547 (1889); Matter of Maitland, 81 App. Div. 633, aff'd., 178 N. Y. 612 (1904).

[141] Matter of Cummings, 193 App. Div. 596 (1920).

[142] Matter of Burr, 118 App. Div. 482 (1907).

Chapter VII

LEGAL CONTROL OF TRUST INVESTING AS SET FORTH IN MASSACHUSETTS COURT DECISIONS

GENERAL RULE OF GUIDANCE.—In Harvard College v. Amory[1] the Supreme Court of Massachusetts enunciated the basic rule which should govern trustees in making investments, unless the grantor had given specific directions in the instrument creating the trust. The Court stated: "All that can be required of a trustee to invest, is, that he shall conduct himself faithfully, and exercise a sound discretion. He is to observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested." A liberal construction has been given to this rule by the courts of Massachusetts for over one hundred years. "If a more strict and precise rule should be deemed expedient, it must be enacted by the legislature. It cannot be introduced by judicial decision without working great hardship and injustice."[2]

TRUSTEE SHOULD INVEST WITHIN A REASONABLE TIME.—In Massachusetts it has been held that a trustee should invest the trust funds within a reasonable time.[3] However, what is a reasonable time is not made clear. It would probably be determined from the circumstances in a particular case, such as the amount of assets on hand, the availability of suitable investments, and business conditions. If a trustee does not keep the principal of the trust constantly invested he will possibly be surcharged a legal rate of interest.[4]

IMPLIED POWER TO INVEST.—The court held in Parkhurst v.

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[1] 9 Pick 446, 461 (1830). See also In re Hunt, 141 Mass. 515, 6 N. E. 554 (1886); Thayer v. Dewey, 185 Mass. 68, 69 N. E. 1074 (1904); Lannin v. Buckley, 256 Mass. 78, 152 N. E. 71 (1926); Dexter v. Dexter, 274 Mass. 273, 174 N. E. 493 (1931); Creed v. McAleer, 275 Mass. 353, 175 N. E. 761 (1931).

[2] Brown v. French, 125 Mass. 410 (1878); Appeal of Dickinson, 152 Mass. 184, 25 N. E. 99 (1890).

[3] Ogden v. Allen, 225 Mass. 595, 114 N. E. 862 (1917).

[4] Fay v. Howe, 1 Pick. 527 (1823); Boynton v. Dyer, 18 Pick. 1 (1836).

Ginn[5] that a trustee may have implied powers to invest and re-invest even though such powers are not expressly given. The duty of a trustee to invest is imposed upon him by law, so it is not necessary that the instrument contain specific directions in that regard.

INSTRUCTIONS IN THE TRUST INSTRUMENT.—If the trust instrument contains instructions regarding investments, the trustee will be bound by such directions.[6]

DISCRETIONARY INVESTMENT POWERS.—There are few decisions in Massachusetts pertaining to discretionary power over investments, due to the fact that in Massachusetts trustees are by law given wide discretion in the matter of investing. They are, however, bound by law to exercise a sound discretion.[7] Even so, powers frequently contained in trust instruments "to invest and reinvest the trust fund in such manner as the trustee may deem expedient," mean virtually nothing.[8] In Davis, Appellant[9] the trustee was given "full power to make . . . investments . . . as to them shall seem expedient;" the trustee to have the same control over the property as the creator then had. The court held that these words merely gave the trustees power to deal with the estate freely and expeditiously but did not release them from the duty to exercise sound judgment and discretion in selecting investments.

In Brown v. French[10] the trustees were authorized to "use their own judgment as to investing the moneys." At the same time the will recommended the propriety of keeping at least half of the estate invested in mortgages or unincumbered realty. The trustees invested a large proportion of the fund in railroad bonds which depreciated in value. Yet, the trustees were exonerated from any liability, the court holding that the will gave them wide discretion to act as they saw fit.

A trust was created for the testator's daughter for life. The trustees were given broad powers to sell the real estate, to invest

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[5] 228 Mass. 159, 117 N. E. 202 (1917); See also Jones v. Atchison, T. & S. F. R. Co., 150 Mass. 304, 23 N. E. 43 (1889); Ogden v. Allen, 225 Mass. 595, 114 N. E. 862 (1917).

[6] Worcester City Missionary Society v. Memorial Church, 186 Mass. 531, 72 N. E. 71 (1904).

[7] See Green v. Crapo, 181 Mass. 55, 62 N. E. 956 (1902) for facts which indicate the exercise of sound discretion.

[8] In certain specific classes of cases discretionary powers of investment may be very important. See Green v. Crapo, 181 Mass. 55, 62 N. E. 956 (1902); Eldredge v. Heard, 106 Mass. 579 (1871); Old Colony Trust Co. v. Shaw, 261 Mass. 158, 158 N. E. 530 (1927).

[9] 183 Mass. 499, 67 N. E. 604 (1903); Kimball v. Whitney, 233 Mass. 321 (1919).

[10] 125 Mass. 410 (1878).

and reinvest and to change investments "in such manner as they may deem most beneficial for the parties interested in the fund." The instrument recommended that the trustees invest in real estate in Boston when a favorable opportunity offered. The estate contained some unproductive real estate in Boston which was enhancing in value. One of the trustees had a half interest in this unproductive land. Some of the other remaindermen were poor. The trustees refused to sell this property on the ground that the income of the trust fund was ample for the beneficiaries. The life tenant objected to this method of handling the estate and sought to compel a sale of the real estate. The court, however, refused to interfere, as the trustees had been given full power to deal with the estate.[11]

"If the trustee exercises the power in good faith and with honest judgment and due regard for the purpose for which the trust was created, and not capriciously or arbitrarily or from fraudulent or selfish motives, his conduct will not be reviewed or controlled by the courts."[12] The testator owned the property and had a right to entrust the discretion to the trustee. "Hence this court will not substitute its judgment for that of the trustee."[13]

Error in Judgment.—"A trustee cannot be held liable for a mere error of judgment in making or failing to make an investment, or in his management of the trust estate in other respects unless the error is so gross as to show that he either acted in bad faith or failed to exercise that sound discretion which the law requires of all trustees in the performance of their official duties."[14]

Exemption.—In North Adams National Bank v. Curtiss[15] it was held that the grantor has the power to expressly exempt a trustee from personal liability. Such a power was deemed to be sufficient to exempt trustees for loss from investments made in good faith. The provision that the trustee was to have "the same dominion and control over said trust property as I now have" did not exempt him from being surcharged for a disproportionate investment. The court held that the trustee was

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[11] Eldredge v. Heard, 106 Mass. 579 (1871); Green v. Crapo, 181 Mass. 55, 62 N. E. 956 (1902).

[12] Newhall, Guy, "Discretionary Powers of Trustees," *Trust Companies*, Vol. 50 (May 1930), p. 731.

[13] Newhall, *op. cit.*

[14] Pine v. White, 175 Mass. 585, 56 N. E. 967 (1900); Taft v. Smith, 186 Mass. 31, 70 N. E. 1031 (1904).

[15] 278 Mass. 471, 180 N. E. 217 (1932).

obligated to use sound discretion and reasonable care.[16] If a trustee does not act within the scope of his powers, an immunity clause is of no protection. Thus, a trustee that was liable "only for the result of his own gross negligence or bad faith" was not exonerated from a wilful and deliberate breach of trust.[17]

PASSIVE TRUSTEESHIP.—The Massachusetts Courts require the trustee to exercise sound discretion, reasonable skill and prudence in the management of a trust. A trustee is liable for easy complacence or negligence for the law does not recognize such a thing as a passive trusteeship. This point was clearly brought out in the case of State Street Trust Company v. Walker.[18] There the court said: "The decline in value of the real estate covered by the Witherell mortgage had begun before the maturity of the note, and this condition could have been discovered by the exercise of reasonable diligence. . . . The State Street Trust Company, if it had examined the securities when it was appointed, could have ascertained the present value of the property, the change in the conditions of the neighborhood and the consequent depreciation. The report of its expert called these matters directly to its attention." The exercise of reasonable skill and prudence would have revealed the situation of the investment and disclosed the proper measures to take in order to protect the rights of the beneficiaries. Since the trustees failed to act they were jointly and severally responsible for the loss and were charged with the investment less the amount received upon foreclosure.

RETAINING INVESTMENTS RECEIVED FROM THE GRANTOR.—The Massachusetts courts have enunciated the principle that the trustee carries the same duty with respect to retaining the investments received from the grantor as in making new investments. The famous case of Harvard College v. Amory[19] is the landmark in this regard. Where the trustee uses reasonable prudence and good faith in retaining the investment, unless the trust instrument contains specific directions to the contrary, he is absolved from loss. The fact that the creator of the trust selected the investments and turned them over to the trustee without instructions to dispose of them, shows that they have his confidence and commends them for retention as part of the trust, so long as there is no doubt of their safety. This principle was recently confirmed in the decision of Creed v. McAleer. Here the court said: "The same rule obtains in regard to property which comes

[16] In re Davis 183 Mass. 499 (1903).
[17] Digney v. Blanchard 226, Mass. 335, 115 N. E. 424 (1917).
[18] 259 Mass. 578 (1927).
[19] 26 Mass. 446 (1830).

to trustees from the testator not specifically bequeathed as obtains in respect to new investments, and when so received it should not be allowed to continue but should be converted properly into safe investments."[20] Although the grantor's investments are proper for the trustee to retain, that fact does not free the trustee from further care. Sound discretion obligates him to give close supervision, to prevent losses as far as possible. It is not necessary to sell, however, merely because an investment is depreciating. A trustee received stock of a railroad as part of the trust estate. There was a falling market and the stock was depreciating in value, but the trustee continued the investment in good faith, believing it would be a sacrifice to sell. The court ruled that this was not chargeable conduct.[21]

If the instrument of trust authorizes the retention of improper investments such authorization will be given due consideration by the courts. Even here, however, the rule of sound discretion is not totally annulled.[22] The trustee should still give adequate supervision and sell whenever conditions so warrant in order to avoid unnecessary losses. However, in North Adams National Bank v. Curtiss,[23] the court said that "retention by trustees of stock authorized by the testator to be retained may have the approval of the court, even though they depreciated greatly in value."

Several Massachusetts decisions have dealt with the question of retaining authorized securities which subsequently changed in form. In re Plunkett[24] the trustee was authorized to retain certain shares of stock. Later the company which these shares represented was consolidated with other companies. The court ruled that the stock of the consolidated company was "an investment in a new entity, different in form and substance . . . and could not be held to be an investment" according to the terms of the will. The court insisted that "taking into consideration the set-up of the Berkshire Mine Spinning Associates, its capitalization, its charter powers, etc., the court finds as a fact that it was a new and different entity from either the Greylock Mills or the Berkshire Manufacturing Company"; . . . The acquisition of said

[20] 275 Mass. 353, 175 N. E. 761 (1931); Dexter v. Dexter, 174 N. E. 493 (1931).

[21] Bowker v. Pierce, 130 Mass. 262 (1881); Green v. Crapo, 181 Mass. 55 (1902).

[22] Discretionary powers of a trust may be subject to court supervision. In re Davis, 183 Mass. 499 (1903).

[23] 278 Mass. 471 (1932). (Speaking of the Old Colony Trust Co. v. Shaw decision.)

[24] Probate Court for Berkshire County, No. 30505. This case is being appealed to the Supreme Judicial Court of Massachusetts.

shares was not authorized under the provisions of the will, but was in violation thereof. The conduct of the trustees . . . constituted an unauthorized and wrongful disposition of the trust estate."

In Anderson v. Bean[25] the trustee owned one-half of the stock of a corporation as trustee and one-half individually. A new corporation was organized in Massachusetts to take over the former one, a Maine company. The trustee was authorized to continue to hold the grantor's stock, so he substituted the stock of the new corporation for that of the old one. The court held that the trustee had not exceeded his authority. The retention provision of the instrument covered the situation on the grounds that the business itself and not the legal form constituted the primary corpus.

If trustees are given broad discretion to continue to hold "as long as they think wise . . . stock in mining companies and any other securities or property" in the estate at the testator's death, even though unproductive of income, or of a kind not usually suitable for trustees to hold, or a larger proportion in one investment than the trust estate should hold, and if the will authorized the trustees to invest money in such property as they might deem wise, such a provision is held to empower the trustees to retain the testator's investments in mining stock. Even after these companies consolidated with others, the stock of the consolidated company was permitted to be retained, the court saying:[26] "The power to retain the stock in the mining companies found in the estate of the testator as a permanent investment is conferred on the trustee by the eighth clause of the will quoted, supra; and the provision of the seventh clause which authorizes the trustee 'to invest all money from time to time in such real or personal property as they may think wise,' by necessary implication broadened the power, conferred by the eighth clause, to retain the stock interest in its then form, into a power to convert or exchange that stock into a stock or interest in a mining corporation to be formed in accordance with law by the merger or consolidation of the Calumet Company and the Osceola Company with other mining companies in which the Calumet Company owned a large if not the controlling stock interest. It results that the stock held by the trustees in the Consolidated Company is an authorized investment and no duty has ever rested upon the trustees either to convert the stock which was in the estate

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[25] 272 Mass. 432 (1930).
[26] Old Colony Trust Co. v. Shaw, 261 Mass. 158 (1927).

into another form of investment or to hold and administer the stock interest as if a conversion had been made at the date of its acquisition."

In both cases, In re Plunkett and in Anderson v. Bean, the courts decided the power of retention applied to stock dividends and to the exercise of stock rights.

CHANGING INVESTMENTS.—It has been emphasized that "investments carefully and judiciously made are not, as a general rule, to be disturbed."[27] "The argument of the tenant for life, that the practice of holding of securities until their maturity would deprive him of the very care and ability in the management of the trust for which he pays compensation to the trustee, can readily be pressed so far as to sanction the practice of trading and trafficking in trust securities, which would be attended with dangerous results to the trust fund."[28] The trustee is not obligated to dispose of investments merely because they have appreciated in value.[29]

The power to change investments may be conferred upon the trustee by the instrument creating the trust, either specifically or by implication.[30]

HOLDING OR DISPOSING OF SECURITIES—FACTS TO BE CONSIDERED.—In the case of North Adams National Bank v. Curtiss[31] are found some pertinent points as to facts to be considered in deciding whether securities should be retained or sold. The investments in question were in securities of the American Telephone and Telegraph Company, General Electric Company, and the First National Bank of Boston. In deciding what course should be taken in regard to holding or disposing of the securities the fact that the investments had been made by the testator and not by the trustee, that the testator had a reputation of being a man of sound business judgment, and that he included in his will provision for the guidance and protection of the trustee, were factors to be considered by the trustee along with the other facts.

HANDLING UNPRODUCTIVE PROPERTY.—In Ogden v. Allen the court said: "It is the duty of trustees in the exercise of sound judgment and discretion to convert unproductive property into an income-producing fund as soon as reasonably can be done

[27] New England Trust Co. v. Eaton, 140 Mass. 532, 4 N. E. 69 (1886); Brigham v. Morgan, 185 Mass. 27, 69 N. E. 418 (1904).

[28] *Ibid.*

[29] *Ibid.* See Eldridge v. Heard, 106 Mass. 579 (1871).

[30] Parkhurst v. Ginn, 228 Mass. 159, 117 N. E. 202 (1917); Jones v. Atchison, T. & S. F. R., 150 Mass. 304, 23 N. E. 43 (1889); Smith v. Haynes, 202 Mass. 531, 89 N. E. 158 (1909).

[31] 278 Mass. 483, 180 N. E. 217 (1932).

under all the circumstances."[32] Where the trustee was given discretionary power over investments he continued to hold real estate which was unproductive.[33] This procedure was upheld by the court.

Wasting Investments.—It has been ruled in Massachusetts that wasting investments, such as mining stocks and securities of a similar nature, are improper investments and in the absence of specific direction in the trust instrument they should not be permitted in a trust portfolio.[34] However, where trustees were given discretionary power to retain as long as they deem wise stock in mining companies, the court held that such terms authorized the trustees to continue the testator's investments in such securities.[35]

Trade and Business.—It is a general rule in Massachusetts, as in most other states, that a trustee may not engage in any special trade or business. In Trull v. Trull,[36] a trustee invested funds in machinery, fixtures and patent rights of a manufacturing concern. The court held that this constituted a misappropriation of funds and made all persons knowingly engaged in it accountable as trustees. Likewise, in Digney v. Blanchard,[37] it was held that a will which authorized a trustee to invest in real estate and real estate mortgages, and to erect and repair buildings upon land belonging to the trust, did not warrant his entrance into a general building and contracting business. Neither may a trustee purchase with the trust funds an interest in a partnership which is operating a business; this would be a breach of duty and render the trustee liable for losses.[38] Without express authorization the courts have held that a trustee should not continue an investment in a partnership.[39]

Realty.—There is no clear-cut case of a Massachusetts court objecting to an investment in reality as such. That there are no disturbing decisions at the present time does not presage an approval of this type of investment under existing conditions. Undoubtedly the courts will scrutinize this form of investment in view of depreciated realty values, lowered returns and high taxes. In two prominent cases the attempted surcharges of the

[32] 225 Mass. 595, 114 N. E. 862 (1917).
[33] Eldredge v. Heard, 106 Mass. 579 (1871); Green v. Crapo, 181 Mass. 55, 62 N. E. 956 (1902).
[34] Creed v. McAleer, 275 Mass. 353, 175 N. E. 761 (1931).
[35] Old Colony Trust Co. v. Shaw, 261 Mass. 158, 158 N. E. 530 (1927).
[36] 95 Mass. 407 (1866).
[37] 226 Mass. 335 (1917).
[38] Trull v. Trull, 95 Mass. 407 (1866).
[39] Kinmouth v. Brigham, 87 Mass. 270 (1862).

trustee for investing in foreign realty were denied.[40] However, in Brigham v. Morgan[41] the court disapproved an expenditure of $80,000 to develop some Kansas realty valued at $12,000. The court said that "it was a hazardous investment in a hazardous class." Improvements may be made on realty for the purpose of maintaining or increasing the earning power unless such expenditures are out of proportion to the value of the realty or the trust principal.[42] It is permissible to acquire realty through foreclosure of a mortgage held in trust in order to protect the trust principal.[43]

MORTGAGES.—First mortgages have long been valid as trustee investments in Massachusetts. Such investments, however, are subject to the rule of sound discretion as laid down in the decisions of Massachusetts courts. This point is noted in the case of Brigham v. Morgan,[44] in which the court said: "The evidence offered to show that, at the time these investments were made, men of prudence, discretion and intelligence in the East, and especially in Boston, as well as conservative institutions for savings, were making just such investments in mortgages, in addition to Western loans similar in all respects to the investments in question, was properly excluded. This is not a case where, as in the case of some well known classes of securities, such as bonds and stocks, it could be shown that they had a general market value and a good reputation so that prudent people had made investments in them. It was simply an attempted development of a piece of land in the outskirts of a certain city. It is manifest that the propriety of such an investment must depend upon the peculiar circumstances surrounding it, and evidence that prudent and conservative men had seen fit to embark in a similar undertaking in some other locality would not aid in passing upon the propriety of this. Either such evidence must be of the most vague and general character, and therefore of no practical value, or, if special, it would lead to an inquiry into special circumstances, and to comparisons in no way helpful." When the trustee failed to demand payment at maturity he was surcharged for the loss as proper diligence would have revealed the depreciation of the real estate covered by the mortgage. In

[40] Thayer v. Dewey, 185 Mass. 68 (1904). The trustee had made a small investment in Chicago realty and no loss had occurred. Amory v. Green, 95 Mass. 413 (1866). The terms of the instrument permitted this type of investment.

[41] 185 Mass. 27 (1904).

[42] Warren v. Pazolt, 203 Mass. 328 (1909).

[43] State Street Trust Co. v. Walker, 259 Mass. 578 (1927).

[44] 185 Mass. 27 (1904).

State Street Trust Co. v. Walker[45] the court concluded: "The decline in value of the real estate covered by the Witherell mortgage had begun before the maturity of the note, and this condition could have been discovered by the exercise of reasonable diligence. The safety and preservation of the principal of the investment were paramount. The amount of interest received was merely incidental. The proximate cause of the loss having been found to be due to the failure of the trustees then in office to foreclose, they were jointly and severally responsible for the loss. The State Street Trust Company, if it had examined the securities when it was appointed, could have ascertained the present value of the property, the change in condition of the neighborhood and the consequent depreciation."

Although second mortgages are generally of doubtful validity as a trustee investment there are extenuating circumstances. If the trustee has used sound discretion second mortgages may be permitted in certain instances. In Taft v. Smith[46] the position of the court was indicated as follows: "We are aware that in several cases in other States it has been stated that a trustee should not invest in second mortgages. While we accept that as a principle generally to be applied, we cannot accept it as an absolute ironclad rule. After all, the true rule is whether under the circumstances sound discretion was exercised, and it cannot be said that under every conceivable practical set of circumstances an investment in a second mortgage is inconsistent with sound discretion."

The court did not make clear the particular conditions that should prevail for investing in a second mortgage. We do not know, even generally, the proper margin that should exist between the mortgages and the value of the realty. Certainly the margin of security should be large under present conditions before allowing a second mortgage. The realty extravaganzas of the past decade do not warrant court approval of many real estate obligations without a thorough check to see if the rule of sound discretion has been obeyed.

CORPORATE STOCKS AND BONDS.—The courts of Massachusetts have taken the position that investments in common stocks conforming to the rule of sound discretion are valid. If the stock represents a substantial company and the amount so allocated is not an unduly large proportion of the trust fund, the investment will be approved.[47] In one case, the court said: "A

[45] 259 Mass. 578 (1927).
[46] 186 Mass. 31 (1904).
[47] Appeal of Davis, 183 Mass. 499, 67 N. E. 604 (1903).

trustee whose duty is to keep the trust fund safely invested in productive property, ought not to hazard the safety of the property under any temptation . . . our cases, however, show that trustees in this commonwealth are permitted to invest portions of trust funds in dividend paying stocks and interest bearing bonds of private business corporations, when the corporations have acquired, by reason of the amount of their property, and the prudent management of their affairs, such a reputation that cautious and intelligent persons commonly invest their own money in such stocks and bonds as permanent investments."[48]

In another case trustees received from the testator funds to invest in "safe and productive stock, either in the public funds, bank shares or other stock, according to their best judgment and discretion." Certain shares of a bank, of an insurance company and of a manufacturing company were retained but the court ruled that the broad language of the will gave the trustees the authority to make such an investment.[49]

A trustee invested in preferred stock of a Massachusetts trust, which was a holding company for stocks of certain electric companies. Although the court held the investment to be legal, it stated that there was some doubt regarding such a security.[50] Another decision held that a trustee may invest trust funds in trust company stock.[51] In fact, investments by trustees in stock of banks,[52] insurance companies,[53], manufacturing corporations,[54] loan and trust company shares,[55] railroad shares,[56] and shares of voluntary associations[57] have been held as proper investments. However, stock of mining or other wasting assets corporations are not proper trust investments.[58] Territorial restrictions have not prevailed; whether or not the corporation whose shares were selected was foreign has been immaterial.[59]

CERTIFICATES OF DEPOSIT.—In the case of Hunt, Appellant[60] the trustee purchased certificates of deposit, payable on time, of a national bank in good standing. The court ruled that such

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[48] Dickenson, Appellant, 152 Mass. 184, 25 N. E. 99 (1890).
[49] Harvard College v. Amory, 26 Mass. 446 (1830).
[50] Kimball v. Whitney, 233 Mass. 321, 123 N. E. 665 (1919).
[51] Sheffield v. Parker, 158 Mass. 330 (1893).
[52] Harvard College v. Amory, 26 Mass. 446 (1830).
[53] *Ibid.*
[54] *Ibid.*
[55] Sheffield v. Parker, 158 Mass. 330 (1893).
[56] Appeal of Dickinson, 152 Mass. 184, 25 N. E. 99 (1890).
[57] Kimball v. Whitney, 233 Mass. 321, 123 N. E. 665 (1919).
[58] Old Colony Trust Co. v. Shaw, 261 Mass. 158 (1927); Creed v. McAleer, 275 Mass. 353 (1931).
[59] Brown v. French, 125 Mass. 410 (1878).
[60] 141 Mass. 515 (1886).

an investment did not subject the trustee to liability for loss resulting therefrom. It was rationalized that such certificates are not promissory notes. Further, it was believed that a certificate of deposit of a national bank was sounder than common stock. In a later decision[61] certificates of deposit of savings banks were approved as a proper trust investment. Due notice was taken that permanent deposits in savings banks may be regarded as "consistent with the probable safety of invested capital;" at least such deposits are so regarded by trustees and prudent men. The question of diligence in choosing the depository or in making deposits in out of state banks has not been raised. The times are auspicious for cases on these points.

NOTES.—Notes secured by good collateral may be considered a proper trust investment.[62] In selecting such notes consideration should be given to the duration of the trust, maturity date of the note, and the power of sale and the saleability of the collateral in the event of a change in business conditions. It is doubtful if an unsecured promissory note or a note secured by indorsement would be legal.

DIVERSIFICATION.—Massachusetts has given judicial recognition to the principle of distributing risk through diversification of investment. Failure to give diversification to portfolios has resulted in surcharging the trustee. In Dickinson, Appellant[63] the trustee invested between 20 and 25 per cent of the trust fund in the stock of the Union Pacific Railroad Company at a premium. The road was heavily indebted as it had been built at a considerable expense. It served a new and comparatively undeveloped country. Thus, its future success was uncertain and an investment in its stock entailed a considerable risk. The trustee invested a second amount of the trust estate nearly equal to the first in the stock of the same railroad. The court held that although the investments had been made in good faith, conservative trustees did not invest so heavily in such securities, and that the investment constituted too great a proportion of the fund in stock of one corporation, hence the trustee should be charged with the amount of the second investment. In another case the trustees were administering an estate of $30,000. They invested at one time $6,500 in the securities of the Atchison, Topeka and Santa Fe Railroad Company. The trustees made

[61] Keating v. Director of United States Veteran's Bureau, 272 Mass. 212 (1930).

[62] Lovell v. Minot, 37 Mass. 116 (1836); Brown v. French, 125 Mass. 410 (1878).

[63] 152 Mass. 184 (1890).

another investment of $5,000 in the bonds and $700 in the stock of the same company. The court disallowed the second investment because the first represented about one-quarter of the trust assets. Although the trustees had acted in entire good faith and on what they believed competent advice, they were held personally liable.[64]

In the case of In re Plunkett[65] 90 per cent of the trust principal was held in the stock of the Berkshire and Greylock companies. No change was required for the sake of diversification, the court saying that it was "within the full knowledge of the fact that the testator directed the trustee to keep this investment as a permanent one."

In Brown v. French[66] the trustee invested a very large proportion of the trust fund in railroad bonds but the court made no mention of the fact. Recently a Massachusetts court stated that no arbitrary rule of the amount of a trust fund that may safely be invested by a trustee in one form of security has been adopted in that state.[67]

The rule of diversification applies to other investments as well as to stocks and bonds. For instance, an expenditure of $470,000 for buildings on land valued at $375,000 which was part of an estate of $920,000, was held to be improper.[68] The same idea was set forth in Brigham v. Morgan.[69] These cases have made it clear that there must not be too great disproportion between a single investment and the total principal.

INVESTMENTS OUTSIDE OF THE STATE.—A Massachusetts court has stated the rule affecting investments outside the state as follows:[70] "There is a grave objection to the investment of a trust fund in the purchase of real estate in a foreign state, where the property is beyond the jurisdiction of our courts and is subject to laws different from our own. On this account it would not be within the exercise of a sound discretion to make such an investment without some good reason to justify the choice of it. Ordinarily it is very desirable that investments which have a local character, like the ownership of real estate, should be within the jurisdiction of the court that controls the

[64] In re Davis, 183 Mass. 499 (1903).

[65] *Supra,* n. 24.

[66] 125 Mass. 410 (1878).

[67] North Adams National Bank v. Curtiss, 278 Mass. 471 (1932). This statement is not in accord with Dickinson, Appellant and In re Davis.

[68] Warren v. Pazolt, 203 Mass. 328 (1909).

[69] *Supra,* n. 27.

[70] Thayer v. Dewey, 185 Mass. 68, 69 N. E. 1074 (1904); see also Amory v. Green, 95 Mass. 413 (1866). See General Laws of Mass., Ch. 172, Sec. 34.

trust. But in this commonwealth there is no arbitrary, universal rule than an investment will not be approved if it consists of fixed property in another state."

TRUST INVESTMENTS IN A DECLINING MARKET.—The standard set for trustees who must operate in the face of declining markets is reasonably clear. In an early Massachusetts case wherein it was endeavored to charge trustees with the depreciation of certain stocks under their supervision, the court said that "trustees are justly and uniformly considered favorably, and it is of great importance to bereaved families and orphans, that they should not be held to make good, losses in the depreciation of stocks or the failure of the capital itself, which they held in trust, provided they conduct themselves honestly and discreetly and carefully, according to the existing circumstances, in the discharge of their trusts. If this were held otherwise, no prudent man would run the hazard of losses which might happen without any neglect or breach of good faith."[71]

The same principles were adhered to in a later case which involved a loss in railroad stock. When the trustee received the stock it was appraised at par and although it depreciated greatly in value he refused to sell the stock because of the sacrifice involved. In supporting the trustee the court said: "In determining whether he would sell this stock, all that was required of the trustee was that he should act with good faith and in the exercise of sound discretion. It is not contended by the appellants that he acted in bad faith. It seems to us from the evidence reported that he acted throughout with an anxious desire to do what was for the best interest of the *cestuis que trust*. He was placed in unexpected and embarrassing circumstances. The railroad company, which has been considered strong and safe, met with reverses, became embarrassed, and its stock was gradually falling in the market. It appeared in evidence that he made inquiries and investigations, and was informed that the directors had made a statement that the road was in good order and that they saw no reason why a dividend could not be paid in January, 1876, and was also informed that one of the directors, and the treasurer, had advised their friends to buy the stock, and had said it was a good investment at sixty dollars per share. We can now see that it would have been wiser to sell the stock. But in judging his acts we should put ourselves in his position at the time. He was considering the question, not whether he should invest in this stock, but whether he should sell the stock

[71] Harvard College v. Amory, 26 Mass. 446 (1830).

bought by the testator, upon a falling market. The evidence shows that he in good faith made investigations, sought information from trustworthy sources, and acted upon such information according to his best judgment. We are of opinion that the presiding justice who heard the case rightly found that, under the circumstances, the trustee acted in good faith and with the sound discretion which the law required of him."[72]

Coming to our own parlous days we find the idea again expressed in Creed v. McAleer.[73] Trustees could not be held to forecast the market change in stock prices in October and November, 1929. They are not wanting in sound discretion "simply because their judgment turned out wrong."[74]

TRUSTEE LIABLE IF HE FAILS TO RECEIVE MARKET PRICE.—In Exchange Trust Company v. Doudera[75] the court surcharged the trustee because he did not use reasonable diligence to secure the market price when he disposed of the investments, but he was not charged for a failure to sell when prices were high.

CORRECTNESS OF AN INVESTMENT JUDGED AS OF THE TIME IT WAS MADE.—The rule in Massachusetts is that an investment must be measured as to legality and fitness according to the time at which it was made, and not in the light of subsequent facts which could not have been foreseen.[76]

SELF DEALING.—Court decisions of Massachusetts have made it clear that the trustee must not profit at the expense of the trust. Where the trustee individually sells to or purchases from the estate such dealings will be carefully scrutinized by the courts. All such transactions are voidable at the discretion of the beneficiary.[77] In Ball v. Hopkins,[78] however, the court said: "If the trustee deals fairly, openly and in good faith, a transaction in which he is personally interested will not be avoided." The burden of proof for self dealing will be on the trustee.[79]

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[72] Bowker v. Pierce, 130 Mass. 262 (1881).
[73] 275 Mass. 353, 175 N. E. 761 (1931).
[74] Green v. Crapo, 181 Mass. 55, 62 N. E. 956 (1902).
[75] 270 Mass. 227, 170 N. E. 73 (1930).
[76] Brown v. French, 125 Mass. 410 (1878).
[77] Hayes v. Hall, 188 Mass. 510 (1905); Attorney General v. Armstrong, 231 Mass. 196 (1918).
[78] 268 Mass. 260 (1929).
[79] Witherington v. Nickerson, 256 Mass. 351 (1926).

Chapter VIII

TRUSTEE'S INVESTMENTS IN ILLINOIS, OHIO AND MISSOURI

TRUSTEE'S INVESTMENTS IN ILLINOIS—STATUTES PERMISSIVE RATHER THAN MANDATORY.—The Illinois courts are only slightly less liberal than those of Massachusetts. They have held that the "statutes are generally permissive rather than mandatory."[1]

PURPOSE OF STATUTES.—Statutes in Illinois "are intended to provide for situations where the instrument constituting the trust does not otherwise provide."[2]

STANDARD OF CARE IN INVESTING TRUST FUNDS.—In the Estate of Leonard A. Busby,[3] the executor was given full power to sell any property. The executor, however, after due consideration, did not sell the property early in the depression. The court ruled that this did not constitute negligence, saying: "The executor devoted . . . all of the facilities available in this large financial institution; that its best judgment was exercised in administering the estate; that it was not guilty of negligence . . ." The court said that the question of negligence must be viewed in prospect and not retrospectively.

In White v. Sherman[4] the court said: "The rule is, that, in the investment of trust funds, the trustee must not only act in good faith, and use sound discretion and reasonable vigilance, but, where he is appointed by a court and is acting under the directions of a court, he must select such securities as the court will approve."

TERMS OF THE TRUST INSTRUMENT.—"The words in an instrument 'with full power to make purchases, investments and exchanges in such manner as to them shall seem expedient,' have been construed to be enabling words giving trustees the power to deal 'fully and expeditiously with the estate' but not releasing

[1] Merchants' Loan & Trust Co. v. Northern Trust Co., 250 Ill. 86, 95 N. E. 58 (1911).

[2] *Ibid.*

[3] P. C. Cook Co., Nov., 1933.

[4] 168 Ill. 589, 48 N. E. 128 (1897); Merchants' Loan & Trust Co. v. Northern Trust Co., 250 Ill. 86, 95 N. E. 58 (1911). The courts of Ill. follow the New York rule, rather than the Massachusetts rule.

them from the obligation to exercise sound judgment and reasonable and prudent discretion."[5] Where trustees were directed to "keep the same invested, in their discretion," the court ruled that it did not authorize the purchase of land and the opening of a coal mine thereon.[6] The Illinois courts have made it clear that the terms of the instrument are binding upon the trustee.[7]

WHEN TRUST INSTRUMENT CONTAINS NO EXPRESS DIRECTIONS.—"It is the duty of a trustee holding funds in trust, with no express or implied directions in the instrument creating the trust as to the management of the fund, to invest the same in good and safe securities."[8] "Where there are no express directions in the instrument creating the trust, and no statutory provisions, in relation to the character of the securities in which trust funds may be invested, a trustee cannot invest such funds in stocks, bonds or other securities of private business corporations."[9] It is the trustee's duty to invest the trust fund in proper securities at lawful interest, exercising the same care and diligence as in the execution of similar business for himself.[10]

DISCRETIONARY INVESTMENT POWERS.—"Where the will gives authority to the trustees to convert realty into personalty or personalty into realty, or invest and reinvest, in their discretion, the trustees may purchase such securities as a prudent and provident person would purchase as good and safe investments, and they are not restricted to the conditions and limitations imposed by law for the investment of trust funds."[11]

RETENTION OF INVESTMENTS MADE BY CREATOR OF TRUST.—Non-legal investments of the testator may be retained by the trustee when so authorized by the trust instrument.[12] When the trustee is given discretion, the fact that the testator bought and held certain securities may well be considered with respect to their retention.[13] The statutes of Illinois state that "any trustee may continue to hold any investment received by him under the trust or any increase thereof."[14]

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[5] Merchants' Loan & Trust Co. v. Northern Trust Co., 250 Ill. 86, 95 N. E. 58 (1911).

[6] Butler v. Butler, 164 Ill. 171, 45 N. E. 426 (1896).

[7] *Supra*, n. 5.

[8] Sholty v. Sholty, 140 Ill. 81, 29 N. E. 1041 (1892).

[9] White v. Sherman, 168 Ill. 589, 48 N. E. 128 (1897).

[10] *Supra*, n. 8.

[11] Merchants' Loan & Trust Co. v. Northern Trust Co., 250 Ill. 86, 95 N. E. 58 (1911).

[12] *Ibid.*

[13] *Ibid.*

[14] Revised Statutes, 1931, as Amended by Subsequent Session Laws, Ch. 148, Sec. 32. (Smith-Hurd).

CHANGE IN INVESTMENT—DIRECTION OF COURT.—In one instance, national bank stock was received in trust. The court ruled that without authorization the trustee could not sanction the conversion of the bank into a partnership and continue the investment in this form. "Changes in investments, or reinvestments, should not be made by trustees as a general thing, unless they are ordered by a chancery court; and, in such case, the trust fund may be withdrawn and reloaned."[15] Power to change investments may be given the trustee by the trust instrument, either specifically or by implication.[16]

WHEN TRUSTEE IS PROTECTED FROM LOSS IN INVESTING.—"A trustee will not be protected from loss in investing trust funds, unless he invests in government or real estate securities, or other securities approved by the court, to which he is accountable."[17]

INVESTMENTS SHOULD NOT BE MADE IN TRUSTEE'S NAME INDIVIDUALLY.—The rule established by Illinois courts is that trust funds should be invested in the name of the trustee as such.[18] "Whatever the actual intention of the trustee may be, the weight of authority seems to be, that, where he invests trust money in his individual name, he commits a breach of trust, which subjects him to the same liability, as if there had been a wilful conversion to his own use."[19] The same rule applies where the trustee makes a bank deposit in his individual name and not in his name as trustee.[20]

INVESTMENTS OUTSIDE THE STATE.—If a trustee is given broad powers to invest, Illinois courts permit him to invest in securities in other states. Since the general statutes confer power to invest in such securities, this appears to authorize investments without the state. Investments which are beyond the geographical limits of the United States are unauthorized.[21]

STOCKS AND BONDS OF PRIVATE CORPORATIONS.—"A trustee should not invest the money of others in his care in the stock or shares of any private corporation."[22] If a trustee invests in speculative railroad stocks, he is personally liable for loss.[23] However, where the trustee had invested in stock of private corpora-

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[15] Penn v. Fogler, 182 Ill. 76, 55 N. E. 192 (1899).
[16] Merchants' Loan & Trust Co. v. Northern Trust Co., 250 Ill. 86 (1911).
[17] *Supra*, n. 15.
[18] White v. Sherman, 168 Ill. 589, 48 N. E. 128 (1897).
[19] *Ibid.*
[20] *Ibid.*
[21] Merchants' Loan & Trust Co. v. Northern Trust Co., 250 Ill. 86 (1911).
[22] Penn v. Fogler, 182 Ill. 76, 55 N. E. 192 (1899).
[23] White v. Sherman, 168 Ill. 589, 48 N. E. 128 (1897).

tions, his action was upheld, because the trust instrument gave broad powers as to the choice of investments.[24]

Corporate bonds are legal investments for trust assets by statute. Public utility bonds are legal investments if they comply with the statute.[25]

TRADE OR BUSINESS.—The court ruled in Penn v. Fogler that an investment in a trade or business is not authorized,[26] unless the trust instrument empowers the trustee to do so.

REAL ESTATE INVESTMENTS.—The investment of trust assets in real estate is improper[27] unless authorized by the trust instrument.[28] Where a trustee was authorized to make such investments he was allowed to invest in land situated in another state.[29]

POWER TO MORTGAGE OR LEASE.—A trustee cannot mortgage property if he is not authorized to sell or convey it by the instrument of trust.[30] If a trustee is empowered to mortgage, rent and lease property, he is permitted to execute ordinary leases. However, he may not sell the property or execute leases equivalent to a sale.[31]

CONSENT BY BENEFICIARY.—Whether the trustee should escape liability in holding improper investments if he has the consent of the *cestui que trust* is still a mooted question in the state courts. The law respecting the approval by the beneficiary of improper investments is well set forth in White v. Sherman.[32] "In order to bind a *cestui que trust* by acquiescence in a breach of trust by the trustee, it must appear that the *cestui que trust* knew all the facts, and was apprised of his legal rights, and was under no disability to assert them. Such proof must be full and satisfactory. The *cestui que trust* must be shown, in such case, to have acted freely, deliberately and advisedly, with the intention of confirming a transaction which he knew . . . with reasonable or proper diligence . . . to be impeachable."

PENALTY FOR NEGLECT OF DUTY.—Like those of a number of other states, the Illinois courts allow the trustee a fair amount of discretion, but when he makes an improper investment, or neglects to invest, he is held strictly accountable. A trustee who

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[24] *Supra,* n. 21.
[25] Illinois Trust & Savings Bank v. Tuley, 226 Ill. App. 491 (1922).
[26] 182 Ill. 76, 55 N. E. 192 (1899).
[27] Butler v. Butler, 164 Ill. 171, 45 N. E. 426 (1896).
[28] Lamotte v. Steidinger, 266 Ill. 600, 107 N. E. 850 (1915).
[29] Merchants' Loan & Trust Co. v. Northern Trust Co., 250 Ill. 86, 95 N. E. 59 (1911).
[30] Summers v. Higley, 191 Ill. 193 (1901).
[31] Ohio Oil Co. v. Daughetee, 240 Ill. 361 (1909).
[32] 168 Ill. 589 (1897).

is guilty of a breach of trust, is liable for interest, with annual rests.[33]

LEGAL CONTROL OF TRUST INVESTMENTS AS SET FORTH IN THE DECISIONS OF OHIO COURTS—STANDARD OF CARE IN INVESTING TRUST FUNDS.—In Ohio it need only be shown that the trustee exercised ordinary prudence and good faith to excuse him from liability for loss in investing trust funds.[34] Again where trustees exercise due diligence and care in making investments, having relied upon the advice of an attorney, they are not liable for a mistake in law.[35]

DUTY OF TRUSTEE TO INVEST.—Trustees are required to invest the trust fund within a reasonable time; failure to do so renders them liable for interest.[36]

DIRECTIONS IN THE TRUST INSTRUMENT MUST BE FOLLOWED.—A trustee must follow the directions of the settlor. "It is not the privilege of the trustee, or of the remainderman, to substitute his judgment as to the manner of investing the funds in the place of the judgment of the donor of the trust property."[37]

WHEN TRUSTEE IS NOT LIABLE FOR LOSS.—When a trustee exercises proper diligence and precaution and relies upon advice of counsel he is not liable for loss.[38]

TRUST INVESTMENTS TO BE KEPT SEPARATE AND IN NAME OF TRUSTEE.—In Ohio the courts have ruled that trust investments should be kept separate.[39] Further, trust funds should be invested in the name of the trustee as such.[40] If a trustee deposits trust assets to his personal account, he is liable for any loss.[41]

CHANGING INVESTMENTS.—A trustee should not change realty into personalty unless so authorized by the trust instrument or by order of court.[42] If an investment is approved by an order of court it should not be changed without authorization from the court.[43]

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[33] Hughes v. People, 111 Ill. 457 (1885); Rawson v. Corbett, 150 Ill. 466 (1894); Steyer v. Morris, 39 Ill. App. 382 (1891).

[34] In re Spencer's Appeal, 2 Ohio Dec. 510 (1861); Willis v. Brancher, 79 Ohio St. 290, 87 N. E. 185 (1909).

[35] Miller v. Proctor, 20 Ohio 442 (1870).

[36] *Supra*, n. 34. See also In re Strickland, 1 Ohio Dec. 702 (1894); Armstrong v. Miller, 6 Ohio 118 (1833).

[37] Willis v. Holcomb, 83 Ohio 254, 94 N. E. 486 (1911).

[38] Miller v. Proctor, 20 Ohio 442 (1870).

[39] Brown v. Williams, 9 Ohio C. C. (N. S.) 307 (1907).

[40] Willis v. Braucher, 79 Ohio St. 290, 87 N. E. 185 (1909).

[41] Shaw v. Bauman, 34 Ohio St. 25 (1877).

[42] In re Spencer's Appeal, 2 Ohio Dec. 510 (1861).

[43] Am. Bonding Co. v. Second Nat'l Bank of Cincinnati, 22 Ohio C. C. (N. S.) 177 (1915).

DISCRETIONARY INVESTMENT POWER.—In Willis v. Braucher[44] the court said: "We do not agree with the proposition that in order to authorize a trustee to invest trust funds otherwise than in accordance with the statute the instrument creating the trust must specify the particular securities to be purchased; it is sufficient if the instrument designates the test to be applied. In the present case the will does so designate by providing that investments may be made in such manner as the trustee may think best."

PROCEDURE WHEN AUTHORIZED INVESTMENTS ARE NOT AVAILABLE.—If the investments specified in the trust instrument are unobtainable, an Ohio court ruled that the trustee should invest in "legals," or in securities prescribed by the court or in such other securities as are deemed safe and proper.[45]

WHEN DIRECTIONS OF GRANTOR MAY BE SET ASIDE.—If complying with the grantor's instructions would result in loss or disadvantage to the beneficiaries, the court has decreed that the trustees might be relieved of the obligation of following such instructions and allowed to select a more advantageous investment.[46]

CONTINUING GRANTOR'S INVESTMENTS.—Trustees are governed by about the same rules in retaining investments as pertains to the making of an original investment. Thus non-legals should be disposed of and the proceeds invested in authorized securities.[47]

CONTINUING GRANTOR'S BUSINESS.—A trustee may not continue the business of the testator after his death, unless specifically authorized by the instrument creating the trust or by order of court.[48]

INVESTMENT IN BUSINESS.—A trustee has no right to invest in a hazardous mercantile business unless authorized to do so by the instrument.[49]

PERSONAL SECURITY.—If a trustee makes a loan upon personal security only, he may expect to bear any losses which result to the estate as a consequence of such a loan. However, if a trustee is given broad investment powers he may make certain investments without security.[50]

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[44] 79 Ohio St. 290, 87 N. E. 185 (1909).

[45] McIntire's Administrators et al v. City of Zanesville, 17 Ohio 352 (1867).

[46] *Ibid.*

[47] See Weyer v. Watt, 48 Ohio St. 545 (1891).

[48] Lucht v. Behrens, 28 Ohio St. 231 (1876).

[49] Adams v. Nelson, 1 Ohio Dec. 216 (1894).

[50] Scott v. Trustees of Marion Township, 39 Ohio St. 153 (1883).

BANK DEPOSITS.—A temporary deposit in a reputable bank is a proper act and the failure of such a bank does not make the trustee liable for the loss to the trust fund.[51] The Ohio Supreme Court decreed that a trust company in Ohio may deposit trust funds in its commercial department pending investment. When funds are so deposited the trust company becomes a debtor of the estate and upon the failure of the company, the estate is a general creditor only and is not entitled to a preference.[52]

MORTGAGES.—First mortgages on real estate are proper trust investments in Ohio, but a trustee should not make a loan for more than two-thirds of the fair appraisal price.[53] Second mortgages, however, should not be accepted by trustees.[54]

STOCK OF CORPORATIONS.—Trustees are not authorized to invest in the stock of corporations,[55] unless empowered so to do by the instrument. But if a trustee is given wide discretion by the trust instrument, he may be permitted to select such stock.[56]

REAL ESTATE.—Normally real estate is not a proper investment for trust funds. But if the probate court approves of such a selection real estate may be purchased.[57]

WHEN TRUST ASSETS DO NOT BEAR INTEREST.—Trust assets, not paid out or distributed because the court has not so ordered, or held up due to litigation carried on in good faith, or upon which no profit has been received, are not entitled to interest.[58]

STOCK DIVIDEND.—Where a corporation issues two shares of stock for one as a result of a surplus and a reorganization, the stock belongs to the principal of the trust.[59]

IMPROPER INVESTMENTS AND LIABILITY OF TRUSTEE.—If a trustee makes an investment without designating it as a trust, the beneficiary may hold him liable for loss or elect to take profits.[60] Use of trust assets by a trustee does not constitute embezzlement if there is no fraudulent intent.[61]

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[51] Odd Fellows' Ben. Assn. of Columbus v. Ferson, 3 Ohio Cir. Ct. 84 (1888).

[52] McDonald v. Fulton, 182 N. E. 504 (1932). The statute permitting this notorious procedure was changed by the legislature in 1933 after the public had been aroused through suffering losses in bank failures.

[53] Appeal of Spencer, 2 Ohio Dec. 510 (1861).

[54] *Ibid.*

[55] In re Trusteeship of Couden, 9 Ohio App. 207 (1917).

[56] Willis v. Braucher, 79 Ohio St. 290 (1909). See statutes for law pertaining to corporate stock as trust investment.

[57] Fourth National Bank v. Hopple, 6 Ohio Dec. 482 (1897).

[58] James v. West, 67 Ohio St. 28 (1902).

[59] Wilberding v. Miller, 90 Ohio St. 28 (1914).

[60] Brown v. Williams, 9 Ohio C. C. (N. S.) 307 (1907).

[61] State v. Meyer, 10 Ohio Dec. Rep. 746 (1890). See Ohio C. C. Dec. 712 (1890).

LEGAL CONTROL OF TRUST INVESTMENTS AS SET FORTH IN THE DECISIONS OF MISSOURI COURTS—DUTY OF TRUSTEE TO INVEST.—The Missouri courts have ruled that the trustee should not allow the trust fund to lie idle.[62] The assets should be invested within a reasonable time, otherwise the trustee will be chargeable with interest.[63]

STANDARD OF CARE IN INVESTING TRUST ASSETS.—In the investment of trust funds the trustee is required to exercise such diligence, prudence and good faith as men of prudence and discretion employ in the management of their own affairs.[64] In the absence of directions in the instrument or statute, the trustee must be governed by sound discretion and good faith.[65]

DIRECTIONS IN THE TRUST INSTRUMENT MUST BE FOLLOWED.—It would seem that a trustee must follow strictly the provisions of the trust.[66]

DISCRETION.—In an instance in which the trust instrument authorized the trustee "to invest in some safe stock, or in any way he may think best" it was decreed by the court that such terms gave the trustee broad discretion.[67]

SAFETY THE PRIME OBJECT.—It is the rule in Missouri that safety of the trust fund should be the principal care of the trustee. The trust assets should not be jeopardized in order to secure a large income.[68]

SPECULATION.—A trustee should not employ the trust assets in speculation; to do so will make him individually liable for losses resulting therefrom.[69]

MINGLING TRUST ASSETS WITH HIS OWN.—Trust funds should be kept separate. If a trustee mingles trust funds with his own, he will be charged with the losses resulting to the estate.[70] Further, he will be liable for interest although none has been earned.[71]

SELF-DEALING.—Missouri courts have decreed that a trustee cannot purchase investments for a trust from himself.[72]

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[62] Drake v. Crane, 127 Mo. 85, 29 S. W. 990 (1895).

[63] Cavender v. Cavender, U. S. C. C., Mo., 8 Fed. 641 (1881).

[64] Cornet v. Cornet, 269 Mo. 298, 190 S. W. 333 (1916); Mann v. Bank of Greenfield, 323 Mo. 1000, 20 S. W. (2nd) 502 (1929); Taylor v. Hite, 61 Mo. 142 (1875). Missouri follows the Massachusetts rule.

[65] *Ibid.*

[66] Gates v. Hunter, 13 Mo. 365, 511 (1850).

[67] Lawson v. Cunningham, 275 Mo. 128 (1918).

[68] Cornet v. Cornet, 269 Mo. 298, 190 S. W. 333 (1916).

[69] *Ibid.*; Drake v. Crane, 127 Mo. 85, 29 S. W. 990 (1895).

[70] Kelley v. Kelley, 213 Mo. App. 492 (1923).

[71] Bates v. Hamilton, 144 Mo. 1 (1898); In re Murdock, 129 Mo. 488 (1895).

[72] Cornet v. Cornet, 269 Mo. 298, 190 S. W. 333 (1916).

INVESTING TRUST ASSETS IN TRUSTEE'S NAME INDIVIDUALLY. —It is improper for a trustee to invest trust assets in his own name as an individual; they should be invested in the name of the trust.[73] It is a breach of trust for a trustee to invest the assets in his own name individually.[74]

CHANGING INVESTMENTS.—Without express or implied power, a trustee may not change the trust property.[75] But when it is of a perishable nature the trustee must convert it into a permanent investment.[76] If a change in investment is for the best interest of the estate it may be effected.[77] A trustee has complete authority to sell or change trust property when the trust instrument gives him express power to sell.[78] However, a trustee may not change the trust estate into a corporation, though the instrument gives him the power to sell and reinvest.[79] If an attempted sale of trust property was not consented to by the required number of beneficiaries as specified in the trust instrument, the beneficiaries can, by injunction, restrain the sale.[80] If the instrument provides that the trustee may change the trust investments with the consent of one or more of the beneficiaries, a sale made in accordance with such a provision is valid if the proper persons have consented.[81]

PERSONAL SECURITIES.—The investment of the trust principal in personal securities is not authorized.[82]

RETAINING INVESTMENTS.—Unless authorized by the instrument, wasting investments should not be retained.[83] If trust funds have been invested in non-legals without authorization, a successor trustee is under no obligation to accept them.[84]

STOCK OF CORPORATIONS.—Without authorization the trustee may not invest trust funds in the stock of private corporations.[85]

REAL ESTATE.—Unless authorized by the trust instrument it is improper for a trustee to invest trust assets in real estate.[86]

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[73] *Ibid.*
[74] *Ibid.*
[75] Garesche v. Levering Inv. Co., 146 Mo. 436, 48 S. W. 653 (1898).
[76] *Ibid.*
[77] Gamble v. Gibson, 59 Mo. 585 (1875).
[78] St. Louis Land etc. Ass'n v. Fueller, 182 Mo. 93, 81 S. W. 414 (1904).
[79] *Supra,* n. 75.
[80] Van Schrader v. Cornet, 3 S. W. (2nd) 706 (1928).
[81] *Ibid;* St. Louis Land etc. Ass'n v. Fueller, 182 Mo. 93, 81 S. W. 414 (1904).
[82] Cornet v. Cornet, 269 Mo. 298, 190 S. W. 333 (1916).
[83] Loud v. St. Louis Union Trust Co., 313 Mo. 552 (1926).
[84] *Supra,* n. 82.
[85] In re Taylor's Estate, Mo. App. 5 S. W. (2nd) 457 (1928).
[86] Lawson v. Cunningham, 275 Mo. 128, 204 S. W. 1100 (1918); see Drake v. Crane, *supra,* n. 69.

INVESTMENTS IN A DEPRECIATED MARKET.—If a trustee has invested in proper and adequate security he will not be liable for later depreciation.[87]

IMPROPER INVESTMENTS AND LIABILITY OF TRUSTEE.—If a trustee uses the assets for his own purposes, or speculated with it and profits cannot be calculated, he may be charged with the highest rate of interest, or with the income that would have been derived from the proper investment, or with simple interest at the legal rate.[88] Interest is not compounded for a single breach of trust.[89]

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[87] State v. Slevin, 93 Mo. 253 (1887).

[88] Bobb v. Bobb, 89 Mo. 411 (1886); In re Davis, 62 Mo. 450 (1876); In re Estate of Danforth, 66 Mo. App. 586 (1896); Kane v. Kane's, Adm'r, 146 Mo. 605 (1898).

[89] Cruce v. Cruce, 81 Mo. 676 (1884); Ames v. Scudder, 83 Mo. 189 (1884).

Chapter IX

DISTRIBUTION OF INVESTMENT IN THE INVENTORY OF TRUSTS

A COMPREHENSIVE study of the aggregate of personal trust funds of trust institutions would be impossible, as this aggregate represents hundreds of thousands of accounts in hundreds of trust institutions scattered throughout the United States. The investment lists of a majority of these accounts would not be available; besides, they would differ in so many respects that such a list would be unwieldy and impossible of a thorough analysis. Consequently this study has been limited to only a representative section of these vast funds.

THE PURPOSE OF THE STUDY.—This study purports to analyze a representative list of trusts from various trust institutions in a number of states. It is undertaken for the purpose of presenting a comprehensive picture of trust institution investment experience from 1919 to 1932.

THE SCOPE OF THE STUDY.—One hundred and ninety-six testamentary trusts were selected from five states. The trust accounts were chosen from the principal city in each state and from the leading trust institutions in the respective cities. In all, nineteen trust institutions were represented: eleven in New York, three in Boston, three in Cleveland, and one each in Chicago and St. Louis. Eighty trusts were selected from the New York institutions, forty-one from Boston, thirty-four from Cleveland, twenty-three from Chicago and eighteen from St. Louis.

Practically all the trusts chosen for analysis had been in existence twelve to fourteen years or longer, and had extended over a common period of time, with the exception of one or two years at the beginning or end of the period studied. The trusts extended from 1919, 1920 or 1921, to 1930, 1931 or 1932. In every case, the trust had been in continuous operation from the time it was received by the trust institution to the last year for which data were collected. Annual data were available throughout the period studied, but no attempt was made to survey the investments for shorter periods than a year.

Table V shows the number of trusts in operation from 1919 to 1932, arranged according to cities.

TABLE V

NUMBER OF TRUSTS ANALYZED, ARRANGED ACCORDING TO CITIES FOR EACH YEAR, 1919-1932

City	1919	1920	1921	to 1929	1930	1931	1932
New York	80	80	80	80	58	43	28
Boston	41	41	41	41	41	41	34
Chicago	16	20	23	23	23	23	20
Cleveland	20	26	34	34	34	34	25
St. Louis	9	13	18	18	18	11	0
Total	166	180	196	196	174	152	107

The number of accounts in each year was quite representative of the aggregate in every respect, and the volume of trust assets was sufficiently large that the trend of investment was not affected by the addition or subtraction of accounts.

The trusts included in this study ranged in size from approximately $10,000 to above $3,000,000, taking the inventory[1] value as a basis. Table VI shows the accounts classified according to size for the five states as an aggregate.

TABLE VI

LISTS OF TRUSTS BY SIZE

Inventory Value	Number of Trusts
$ 25,000	36
$ 25,000- 75,000	50
75,000- 200,000	42
200,000- 500,000	42
500,000- 1,000,000	10
1,000,000-and over	16
Total	196

THE REPRESENTATIVE CHARACTER OF THE STUDY.—Although the states included in this study were selected partly as a matter of expediency, it is felt that they afford a good cross-section of trust institution experience both as to legal and economic aspects of trust investing. The investment practice of the nineteen trust institutions in the handling of the 196 trusts analyzed is undoubtedly indicative of the work of trust institutions throughout the country. They are the largest and oldest houses in the trust field, and are located in important economic and industrial centers having large populations.

[1] The inventory represents the value of the trust principal when it was handed over to the trust institution.

The volume of personal trust business handled by trust institutions in these five jurisdictions aggregates billions of dollars, representing probably a large per cent of the total personal trust business of all trust institutions in the United States.

A sufficiently large number of trusts were chosen from each city to make the data analyzed representative of the trust investment practice in those cities. Trusts were selected and combined in New York, Massachusetts, and Ohio until the composite data for each of these states showed no perceptible change by the addition of a new trust. While the same procedure was not employed for Chicago and St. Louis, it is felt that the data from these areas are typical.

The trusts are representative not only in a quantitative sense, but also from a legalistic point of view. For instance, it is doubtful if any of the remaining states, except Pennsylvania, have legal regulations governing the making of trust investments which differ materially from those found in these five states. New York typifies the states which through statutes and court decisions strictly regulate the investments of trust funds by trustees. There, the law prescribes a list of statutory investments, consisting principally of government securities, certain bonds, and mortgages. Thus, in the states following this principle, the scope of trustee investing is definitely circumscribed unless the trust instrument broadens the trust institution's power. On the other hand, Massachusetts is quite liberal. It has a prescribed list of statutory trust investments but requires the trustee to follow the list only when definitely restricted by the provisions of the trust instrument.

SOURCES OF DATA.—The sources of material used in the preparation of this section of the study have been two, namely, probate court statistics and trust institution records. The investment data of trusts representing trust institutions in New York, Boston and Cleveland were taken from the surrogate court records, or probate court records in these states.[2] The data from Chicago and St. Louis were selected from the files of trust institutions in these cities.[3]

THE PLAN OF THE STUDY.—For convenience and clarity in presentation, the study of the actual trust investment data is

[2] Trust institutions in New York are required to file a complete accounting of each testamentary trust upon its termination. In Massachusetts trustees must file a detailed, yearly accounting, while Ohio trust institutions must render a complete accounting bi-annually covering each testamentary trust.

[3] Trustees in Illinois and Missouri are not required to report their investments to the probate court.

presented in various chapters. In this Chapter an analysis is made of the inventory assets of the trusts. In the following chapters are presented an analysis of the investment experience of trust institutions as reflected in the investments of the 196 trusts from 1919 to 1932.

CHARACTERISTICS OF THE INVENTORY ASSETS OF TRUSTS.—When funds are handed over to the trust institution they are likely to be a heterogeneous collection of securities, real estate and cash. The trust property may, however, be a single item of real estate, railroad bonds or stocks of an individual company, mortgages, etc. The reason for this arises chiefly in the nature of their origin. Practically every trust represents a different individual. The trust property is the grantor's accumulated wealth, which may have come from a single source or from a variety of businesses. The assets may represent standard well-known investments or they may be securities of obscure enterprises, probably well-known only to the grantor.

THE BEGINNING OF THE TRUSTS.—Although some of the trusts were received by the trust institutions as early as 1893, the vast majority took effect much later. Except in New York, there was no appreciable difference between the types of investment contained in the inventories of the trusts at the time they were received by the trust institutions. This is explained in part by the fact that in New York many of the accounts were created prior to 1915, going as far back as 1893, while in the other cities the vast majority of the trusts came into existence after 1915. The noticeable variations in New York were that real estate occurred chiefly in the accounts arising prior to 1915; mortgages and real estate bonds occurred chiefly in the trusts which were received before 1916. Stocks, however, both common and preferred, figured largely in the accounts set up after 1915.

DISTRIBUTION OF INVENTORY ASSETS BY TYPES OF INVESTMENT.—A composite of the investments contained in the 196 trusts when they were received by the trust institutions is presented in summary form in Table VII on page 142.

The data show that the trust assets in the inventory of the 196 trusts were widely diversified, comprising nearly all the principal types of investments. While the total principal was spread over many types of investment, it showed some concentration. A larger percentage of the aggregate assets, 18.0 per cent, was in real estate proper than in any other item. Over 80 per cent of the real estate came from the New York trusts, primarily from those of $500,000 or larger. Industrial common stocks (apparent in nearly equal amounts in New York, Boston, Chicago, and

TABLE VII

DISTRIBUTION OF INVESTMENT IN THE INVENTORY OF 196 TRUSTS BY TYPES

Type of Investment	Per cent of total	No. of trusts carrying each type of investment	Number of trusts with indicated per cent of total investment in specified type of investment.					
			0-5%	5-10%	10-25%	25-50%	50-75%	75-100%
United States Bonds	2.9	59	33	9	8	4	3	2
State and Municipal Bonds	3.5	44	18	6	11	6	2	1
Railroad Bonds	6.6	72	26	12	18	8	6	2
Utility Bonds	2.8	52	22	13	11	5	1	0
Industrial Bonds	.8	47	31	9	5	1	0	1
Railroad Preferred Stock	1.5	45	22	12	8	3	0	0
Utility Preferred Stock	.8	43	23	6	8	4	1	1
Industrial Preferred Stock	4.5	83	33	17	17	10	4	2
Railroad Common Stock	10.3	58	13	15	16	10	4	0
Utility Common Stock	8.2	64	17	14	18	8	5	2
Industrial Common Stock	14.0	88	15	13	21	17	14	8
Bank Stocks	6.0	55	22	12	15	5	0	1
Real Estate Obligations[a]	9.8	90	24	14	19	12	8	13
Real Estate	18.0	54	11	8	8	9	10	8
Cash and Miscellaneous	10.3							
Total	100.0							

[a] Does not include Land bank bonds.

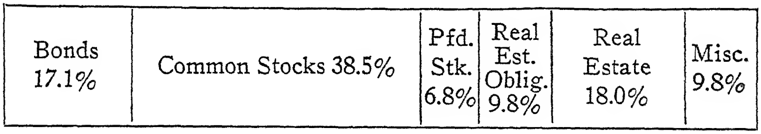
Cleveland) ranked second and constituted 14.0 per cent of the total fund. Railroad common stock made up 10.3 per cent of the composite fund. No other type of investment constituted as much as 10 per cent of the aggregate. Cash, however, amounted to slightly less than 10 per cent.

In New York, real estate proper was the predominate type of investment, constituting 14.6 per cent of the total assets in the inventory.[4] Industrial common stocks were the leading type of investment in Boston, Chicago, Cleveland and St. Louis. They comprised over 20 per cent of the assets of the trusts examined in each of these cities.

Distribution of Investments in the Inventory According to Class.—The data of Table VII are presented graphically in Chart I, to show the relative amount of investment in bonds, stocks, real estate, cash and miscellaneous items.

CHART I

Distribution of Investments in the Inventory of 196 Trusts According to Class



The data show the predominant position of stocks over other types of investment. The value of common stocks was more than double that of any other class of investment, comprising 38.5 per cent of the total assets. Common and preferred stocks together amounted to 45.3 per cent of the aggregate investments. These figures indicate that stocks were highly favored by the grantors. Real estate and real estate obligations combined comprised 27.9 per cent of the total assets, and made up the second principal class of investment. Bonds constituted 17.1 per cent of the inventory assets.

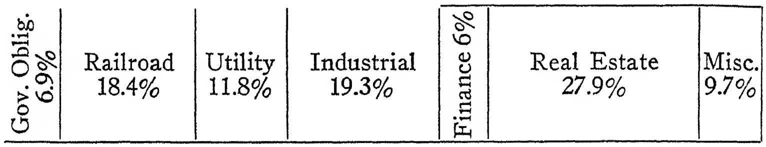
Common stocks were the principal class of investment in four states, constituting 49.4 per cent of the Boston trusts, 39.3 per cent in Chicago, 53.5 per cent in Cleveland and 47.5 per cent in St. Louis. In New York, bonds were the leading class, comprising 26.5 per cent of the total trust assets.

[4] Each trust was counted as of equal value, regardless of size. If the investments were measured on the basis of the actual amount invested in each type of security as an aggregate for all the trusts, then real estate constituted over 20 per cent of the total fund in the inventory of the New York trusts.

DISTRIBUTION OF INVESTMENTS IN THE INVENTORY ACCORDING TO FIELDS.—Chart II shows graphically the investments in the inventory of the 196 trusts according to fields.[5]

CHART II

DISTRIBUTION OF INVESTMENTS IN THE INVENTORY OF 196 TRUSTS ACCORDING TO FIELDS



Real estate and real estate obligations combined form the principal field of investment in the inventory. Industrial obligations amounting to 19.3 per cent were the second largest field; this is principally due to the predominance of industrial common stocks. Railroad obligations come third, totaling 18.4 per cent. Government securities composed but a small part of the aggregate value of the 196 trusts.

In the New York trusts real estate and real estate obligations combined constituted 28.4 per cent of the total fund, and were the principal field of investment. In the remaining cities, industrials were dominant; this is primarily due to the role of industrial common stocks.

NUMBER OF TRUSTS CONTAINING EACH TYPE OF INVESTMENT IN THE INVENTORY.—Table VII also shows the number of trusts containing each type of investment at the time at which the property was handed over to the trust institutions. It may be seen from these data that real estate obligations, industrial common stocks, and industrial preferred stocks were the types most frequently found in the inventories of the 196 trusts. Each of these types of investment was contained in over 42 per cent of the accounts. Railroad bonds and utility common stocks were the types of investment next most frequently noted in the inventory, being listed in approximately 33 per cent of the trusts. Utility preferred stocks were contained in comparatively few trusts, appearing in only forty-three of the one hundred ninety-six accounts. Common stock as a class was found in more trusts than any other class of investment. Utility preferred stocks, state and municipal bonds, industrial bonds, and railroad preferred stocks were held in few accounts, each occurring in less than 25 per cent of the total number.

[5] The data are summarized from Table VII.

Although the foregoing data give the information for the 196 trusts as an aggregate it is interesting to note how the accounts from the various cities compared with respect to the types of investment contained in the inventories. In New York the types of investment appearing in the greatest number of trusts were railroad bonds, railroad preferred stocks and real estate obligations. However, none of these was found in as many as 50 per cent of the accounts. Industrial preferred stocks, industrial common stocks, and utility common stocks occurred most often in the Boston trusts, being listed in over 50 per cent of the accounts. The types of investment most frequently found in the Chicago trusts were real estate obligations (chiefly mortgages), industrial common stocks, and utility bonds. Each of these investments was present in over 50 per cent of the trusts. The predominant type of securities appearing in the Cleveland trusts were real estate obligations, industrial preferred stocks, and industrial common stocks, each being found in more than half of the accounts. Fifty per cent or more of the St. Louis trusts contained industrial preferred stocks, industrial common stocks, and United States government bonds.

PROPORTION OF TRUST FUNDS CONTAINED IN VARIOUS TYPES OF INVESTMENT IN THE INVENTORY.—The data on the number of trusts carrying the different types of investment and the per cent that each type contributed to the total investment are given in Table VII. There it is shown that when the trust property was handed over to the trust institutions, forty-two accounts contained 75 per cent or over in one type of investment. Thirteen of the forty-two had this percentage invested in real estate obligations, eight in real estate, and eight in industrial common stocks. Of the trusts containing so large a proportion in one type of investment, twenty-one listed real estate in some form, fifteen showed stocks and six carried bonds. A further indication of concentration is that fifty-seven accounts each contained 50 to 75 per cent in one class of security; twenty-seven of the fifty-seven showed this percentage in stocks. In general, stocks constituted a larger proportion of more accounts than any other item. Real estate in some form came next. Fifty per cent or more of the value of forty-two trusts was in stocks; thirty-nine trusts had an equivalent proportion in real estate and real estate obligations combined. Many of the accounts which listed bonds showed a very small proportion invested in any one type of bond. A survey of the fields of investment shows that industrial securities were favored second only to real estate in that the former made up 50 per cent or more of twenty-eight accounts.

Chapter X

INVESTMENTS OF TRUST INSTITUTIONS—DIVERSIFICATION ACCORDING TO CLASSES

IN the preceding Chapter a brief survey was presented of the investments contained in the trusts as received by the trust institutions. The investment experience of the trust institutions in the administration of these funds over a period of years will now be analyzed. In this Chapter we shall study the distribution of the investments according to classes.

How the Investments of the 196 Trusts as a Composite are Diversified by Types, 1919-1932.—Table VIII gives the relative diversification of trust investments[1] by the nineteen trust institutions, taken as a total of all the trusts, for each year, 1919-1932. It also shows the distribution of investments contained in the inventory and the average per cent for each type of investment for the fourteen years. The data of Table VIII are graphically illustrated in Chart III shown on page 148.

A perusal of the data above indicates certain definite movements in the handling of the investments. By 1919, the proportions had been varied to the following extent in comparison with the distribution in the inventory: state and municipal bonds, and all corporate bonds had been increased, especially the state and municipal bond and railroad bond groups; in the preferred stock group, the rails were increased, the utilities decreased and the industrials were unchanged; the percentage in all common stocks had dropped; real estate was also decreased. None of the above changes, however, had been of a major character. Real estate obligations had jumped from 9.8 per cent in the inventory, to 16.5 per cent in 1919. Thus, in general, the policy had been to decrease the holdings in stocks, and to allocate the funds thus obtained, along with the cash received in the inventory, to real estate obligations, railroad bonds, and state and municipal bonds.

Trends in Investment from 1919 to 1932.—The percentage in United States government bonds rose considerably in 1920 and

[1] The investments made by the various trust institutions were carried at cost, a practice sanctioned by the law. However, where an investment had been received from the creator of the trust and continued by the trust institution it was carried at the inventory value.

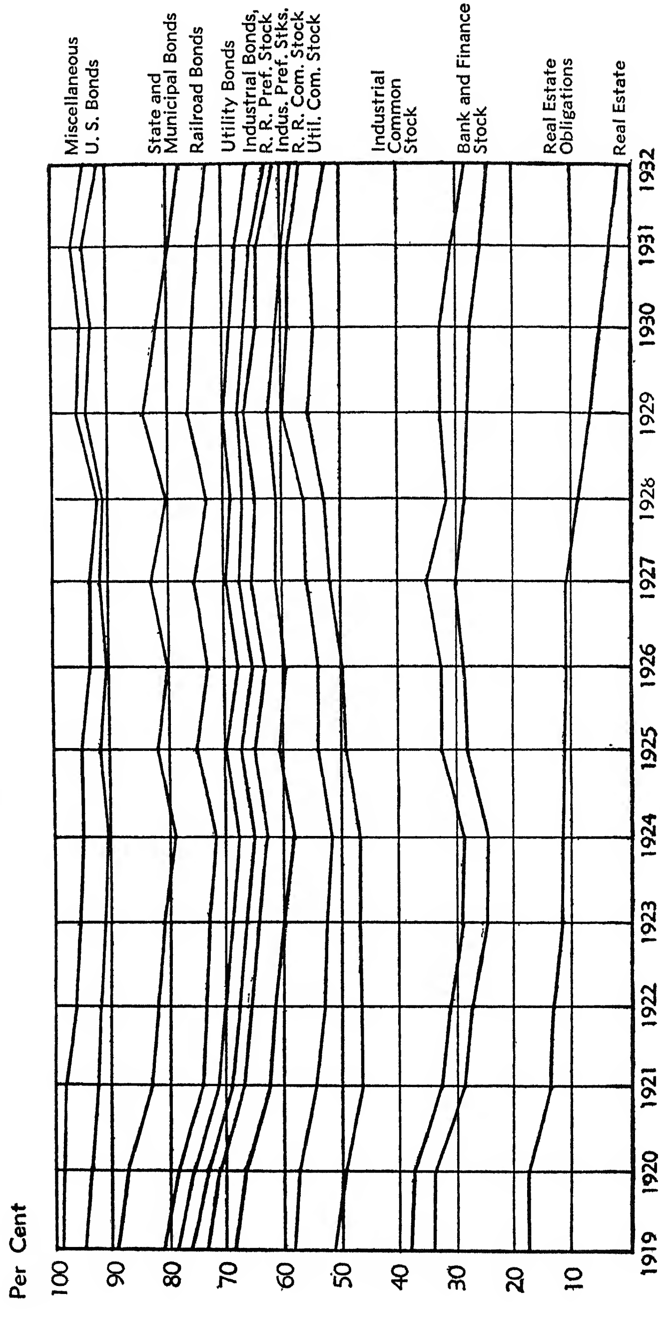
TABLE VIII

RELATIVE DISTRIBUTION OF TRUST INVESTMENTS OF 196 TRUSTS BY TYPES IN EACH YEAR, 1919-1932

TYPE OF INVESTMENT	Inventory	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932	Average
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
United States Bonds	2.9	3.0	4.4	5.7	4.7	4.9	5.2	4.0	3.2	1.7	1.3	1.6	2.0	2.5	3.1	3.4
State and Municipal Bonds	3.5	5.9	6.4	9.8	10.6	10.6	10.4	10.4	10.3	10.3	10.5	10.9	11.3	13.6	14.1	10.4
Railroad Bonds	6.6	9.1	8.8	8.4	8.5	8.0	8.2	8.0	8.0	8.1	7.6	6.0	5.6	5.4	5.1	7.5
Utility Bonds	2.8	2.8	2.8	2.9	3.2	3.5	4.2	4.3	4.3	4.6	5.1	6.9	7.5	7.9	8.6	4.9
Industrial Bonds	0.8	1.6	1.5	1.8	2.1	2.5	2.2	2.1	2.0	1.8	1.7	2.2	2.4	2.8	2.9	2.1
Foreign Bonds	0.5	0.5	0.5	1.0	1.0	1.0	0.9	0.9	0.4	0.4	0.4	0.7	0.6	0.6	0.5	0.7
Railroad Preferred Stock	1.5	2.7	2.6	2.6	2.4	2.3	2.2	2.1	2.1	1.8	1.4	1.3	1.3	0.7	0.7	1.9
Utility Preferred Stock	0.8	0.7	0.7	0.7	0.7	0.8	0.8	0.9	0.9	0.7	0.8	0.9	1.1	0.6	0.7	0.8
Industrial Preferred Stock	4.5	4.5	4.5	4.5	4.5	4.5	4.4	4.4	3.9	3.8	3.2	3.7	3.6	3.1	3.0	4.0
Railroad Common Stock	10.3	10.1	9.9	8.5	7.8	7.2	6.8	6.7	6.4	6.4	4.8	2.7	2.5	1.8	1.7	6.0
Utility Common Stock	8.2	8.1	7.9	7.0	5.9	5.4	5.3	4.2	3.8	3.6	3.8	3.7	3.2	3.4	3.2	4.9
Industrial Common Stock	14.0	12.4	12.1	14.0	15.8	17.5	17.5	17.0	16.8	17.7	20.9	22.8	22.8	23.5	23.4	18.1
Bank and Finance Stock	6.0	4.4	4.4	4.3	4.3	4.1	4.0	4.0	3.7	3.7	3.7	5.0	4.9	4.6	4.1	4.2
Land Bank Bonds	0.1	0.0	0.0	0.1	0.9	1.8	1.8	2.4	2.4	2.4	2.8	3.0	3.1	2.2	2.0	1.8
Real Estate Obligations	9.8	16.5	15.9	13 5	13.0	13.1	13.0	16.3	17.5	18.9	19.1	21.5	22.0	22.6	22.3	17.4
Real Estate	18.0	17.0	16.9	14.8	13.6	12.2	11.8	11.8	11.4	11.0	8.8	6.2	5.1	3.8	3.0	10.5
Miscellaneous	9.7	0.7	0.7	0.4	1.0	0.6	1.3	0.5	2.9	3.1	4.1	0.9	1.0	0.9	1.6	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100 0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

CHART III

RELATIVE DISTRIBUTION OF TRUST INVESTMENTS OF 196 TRUSTS BY TYPES IN EACH YEAR, 1919-1932



1921, remained practically constant at approximately 5 per cent to 1924, then dropped to 1.3 per cent by 1928. They were gradually increased to 3.1 per cent by 1932. The proportion in state and municipal bonds was increased from 1919 to 1922, but remained practically constant thereafter to 1929. These bonds made up 14.1 per cent of the total in 1932. Railroad bonds showed a fairly steady decrease throughout, while utility bonds rose gradually from 2.8 per cent in 1919 to 8.6 per cent in 1932. Industrial bonds were rather insignificant at all times, but increased slightly.

All classes of preferred stocks decreased throughout the period, 1919-1932. Industrial common stocks made a substantial gain, rising from 12.4 per cent in 1919 to 23.4 per cent in 1932. The percentage increase in this item came entirely from an appreciation in these stocks, and not from further commitments, as is evident from the fact that the number of accounts carrying this type of investment decreased. Further, many of the accounts investing in industrial common stocks gradually decreased the proportion so invested. Railroad and utility common stocks were steadily decreased. Bank and finance stocks were rather static for the entire period.

Real estate obligations decreased for five years, falling from 16.5 per cent in 1919 to 13.0 per cent in 1922. From this point, however, there was a substantial increase in the proportion allocated to this type of investment. In 1931 it amounted to 22.6 per cent and in 1932 to 22.3 per cent. Land Bank bonds (including both Federal Land Bank bonds and Joint Stock Land Bank bonds) also made an appreciable gain. They came in around 1923 and rose to 3.1 per cent by 1930, decreasing thereafter. Real estate steadily dropped throughout, falling from 17.0 per cent in 1919 to 3.0 per cent in 1932.

It should be noted that these trends were effected while the principal of the trusts in the aggregate increased nearly 26 per cent. The major part of the gain in principal came from the sale of some common stocks and real estate which had appreciated in value. The funds received from common stocks, real estate, and preferred stocks were invested in real estate obligations and bonds. Such investments necessarily must have been large to make these items register a substantial gain in the face of a growing principal.

COMPARISON WITH LIFE INSURANCE COMPANIES.—In Table IX is exhibited a comparative distribution of investments according to types in trust institutions and life insurance companies for 1932.

TABLE IX

COMPARATIVE DISTRIBUTION OF INVESTMENTS BY TYPES IN TRUST INSTITUTIONS AND LIFE INSURANCE COMPANIES FOR 1932

Type of Investment	Trust Institutions[a]	Life Insurance Companies[b]
United States Bonds	3.1%	2.1%
State and Municipal Bonds	14.1	3.8
Railroad Bonds	5.1	15.1
Utility Bonds	8.6	8.7
Industrial Bonds	2.9	1.8
Foreign Bonds	0.5	2.5
Railroad Preferred Stocks	0.7	0.4
Utility Preferred Stocks	0.7	0.8
Industrial Preferred Stocks	3.0	1.0
Railroad Common Stocks	1.7	0.1
Utility Common Stocks	3.2	0.1
Industrial Common Stocks	23.4	0.4
Bank and Finance Stocks	4.1	0.0
Land Bank Bonds	2.0	0.0
Real Estate Obligations	22.3	36.3
Real Estate	3.0	4.0
Miscellaneous	1.6	22.9
Total	100.0	100.0

[a] See Table VIII, page 147.

[b] *Proceedings of the Twenty-Sixth Annual Convention of the Association of Life Insurance Presidents,* (1932), p. 104.

Trust institutions contained a much larger percentage than life insurance companies in state and municipal obligations and in various common stocks, especially industrial common stocks. On the other hand life insurance companies carried a much larger proportion of their investments in railroad bonds and real estate obligations. Policy loans and premium notes (included under miscellaneous) made up 18.4 per cent of the assets of life insurance companies. Each trust account being comparatively small and a unit in itself, is more mobile than is the huge fund of a life insurance company. Undoubtedly this enables trust institutions to more readily reallocate large proportions of trust funds to different types of investment. In this regard there was a substantial increase in the proportion invested in government bonds and in public utility bonds during the depression. In the case of life insurance companies there was a decrease in the percentage invested in government bonds. Of the new investments during 1932 insurance companies placed 19 per cent in United States government bonds and 14.8 per cent in state and municipal bonds. These items were exceeded only by the pro-

portion placed in city mortgage loans, which was 31.8 per cent.

DISTRIBUTION OF INVESTMENTS ACCORDING TO CLASS.—As to composite classes of investments selected, trust institution investments may be divided into the following classes; bonds, preferred stocks, common stocks, real estate obligations, and real property. Each of these classes of securities is in turn made up of a great variety of forms and types as may be seen from the brief description of these broad groups in the following pages. Although this classification is not a complete index of the investments, it brings out a significant phase of diversification, an important element of any investment program.

Investments as large in volume as those held by the trust institutions discussed here may be expected to reveal a rather broad distribution among the general classes of securities. This distribution is set forth in Table X for each year, 1919 to 1932, as shown on page 152. Chart IV on page 153 graphically portrays the distribution of the composite assets according to classes of investment.

CLASSES OF SECURITIES.—At the turn of the century, there were few varieties of securities available for trust investment. They consisted mainly of small, single first mortgages on real estate—usually upon dwellings or farms—municipal bonds, to some extent horse and electric railway bonds, and first mortgage steam railway bonds. Today there are over 200 types of investment securities, including mortgage bonds, collateral trust bonds, debenture bonds, equipment trust securities, and miscellaneous bonds, foreign bonds, municipal bonds, and common and preferred stocks, compared with a mere handful a quarter of a century ago.[2]

BONDS—NATURE AND CHARACTERISTICS.—The business enterprise is the user of capital, and the investor is the supplier of capital. Modern investment gives rise to a definite relation between these two. In the case of bonds the supplier of funds transfers them to the user on the basis of a specific contract. Thus the bondholder occupies the position of creditor and the borrower that of debtor. Bonds, then, are contractual instruments, a corporate promise to pay at some specified time the principal[3] with interest. If the promises contained in the bond are not fulfilled the bondholder has the right to foreclose on the pledged property or to sue for breach of contract.

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[2] Stone, Ralph, "The Trust Institution—Its Growth and Development," *Trust Companies*, Vol. 54 (Feb. 1932), p. 191.

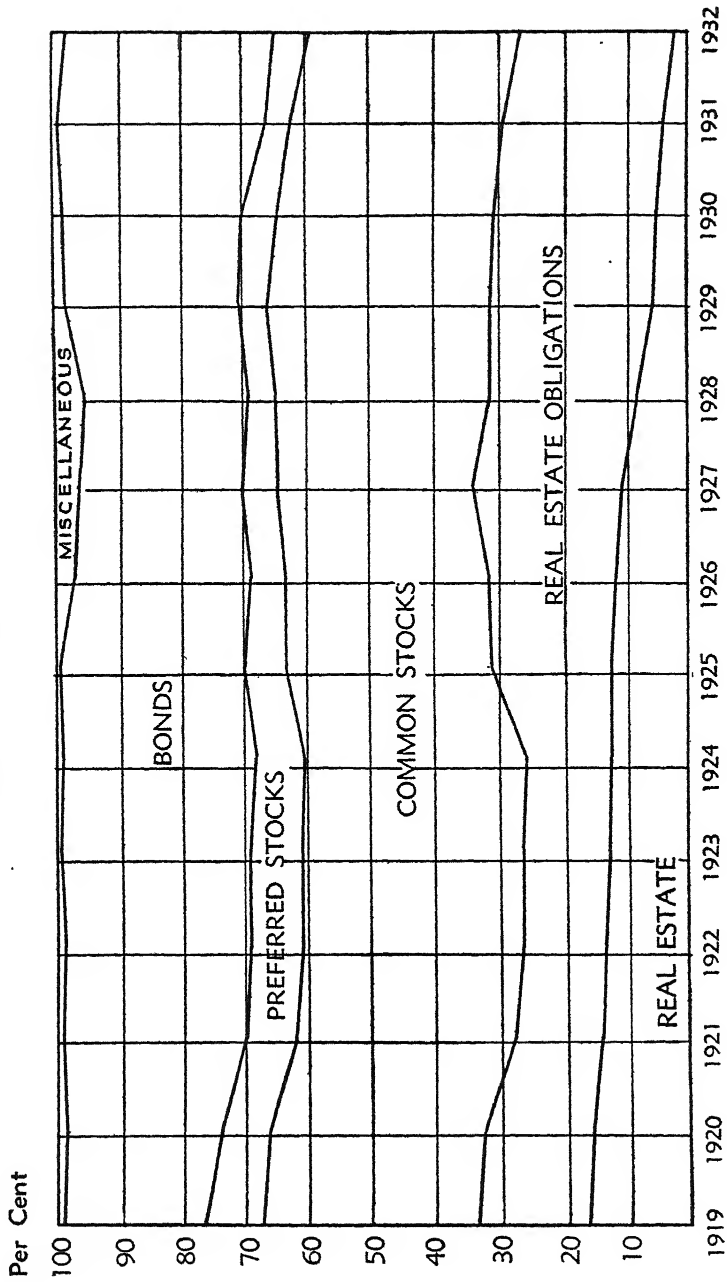
[3] Some bonds, however, have no maturity date.

TABLE X

RELATIVE DISTRIBUTION OF TRUST INVESTMENTS OF 196 TRUSTS BY CLASSES IN EACH YEAR, 1919-1932

CLASS OF INVESTMENT	Inventory	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932	Average
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
Bonds	17.1	22.9	24.4	29.6	30.1	30.5	31.1	29.7	28.2	26.9	26.6	28.3	29.4	32.8	34.3	28.9
Preferred Stocks	6.8	7.9	7.8	7.8	7.6	7.6	7.4	7.4	6.9	6.3	5.4	5.9	6.0	4.4	4.4	6.6
Common Stocks	38.5	35.0	34.3	33.8	33.8	34.2	33.6	31.9	30.7	31.4	33.2	34.2	33.4	33.3	32.4	33.2
Real Estate Oblig.	9.9	16.5	15.9	13.6	13.9	14.9	14.8	18.7	19.9	21.3	21.9	24.5	25.1	24.8	24.3	19.4
Real Estate	18.0	17.0	16.9	14.8	13.6	12.2	11.8	11.8	11.4	11.0	8.8	6.2	5.1	3.8	3.0	10.5
Miscellaneous	9.7	0.7	0.7	0.4	1.0	0.6	1.3	0.5	2.9	3.1	4.1	0.9	1.0	0.9	1.6	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

CHART IV
RELATIVE DISTRIBUTION OF TRUST INVESTMENTS OF 196 TRUSTS BY CLASSES
IN EACH YEAR, 1919-1932



KINDS OF BONDS.—Bonds are alike in that they are contractual instruments representing an indebtedness. In other respects, however, there are wide differences. The chief differences in the investment contracts pertain to the legal nature of the claim which the bondholder has against the assets and earnings of the issuer. There are a great variety of corporate bonds specifically and directly secured by property composed of three groups: (1) mortgage bonds, (2) collateral trust bonds, and (3) equipment securities. In the mortgage group, there is the first or senior lien, comprising a great variety of first mortgage bonds on railroads, traction companies, power and light companies, manufacturing enterprises, and even on mines and quarries. The second or junior mortgage bonds comprise a list outnumbering that of the first mortgage bonds. In the junior group are found a multitude of second and third mortgage bonds, general mortgage bonds, and others with such titles as: "first and general mortgage," "first and refunding," "improvement bonds," "extension and refunding," "first consolidating," "prior lien bonds," "blanket mortgage," etc. Mortgage bonds are likewise issued either under an open-end mortgage, a limited open-end mortgage, or a closed-end mortgage. All told, there are probably nearly fifty varieties of mortgage bonds. Collateral trust bonds and equipment securities are not so numerous, yet they constitute an important list.

Another major division of bonds consists of those secured primarily by credit. Among this group are found such names as: "receiver's certificates," "assumed bonds," "guaranteed bonds," "joint bonds," "participating bonds," and various kinds of debentures, while a financial reorganization brings forth "income" or "adjustment" bonds. Then there are special types of bonds, or special features in the bond contract to make them more attractive. Among this group appear such varieties as "callable bonds," "convertible bonds," conversion bonds with callable features, and bonds with detachable purchase warrants. Just what these particular terms mean, however, does not always appear upon the surface; hence the investor must always be on his guard to see that he gets those bonds with features most desirable from his standpoint.

Another basis for the classification of bonds is the purpose for which the bond is issued: "funding" or "refunding" bonds, to provide funds for payment of bonds about to become due; "consolidated bonds," to retire and consolidate all the various bonds previously issued into one issue; "purchase money bonds" to pay for additional property; "construction bonds" to secure

money for new construction; "temporary bonds" to tide the corporation over a short period; and "extended bonds" created to extend the payment of principal beyond the stated maturity date.

Turning from corporate to municipal bonds, we find the number equally as varied. Classified according to the purpose of issue they are "special assessment bonds," floated to enable the city to make some special improvement; "tax-anticipation warrants"; "water bonds," "paving bonds," "sewer bonds," "sanitary bonds," "drainage bonds," "irrigation bonds," "reclamation bonds," and countless others. Many of these overlap the territory of previous issues to such an extent that only an expert can determine the soundness of any municipal security within a given section. Among the government group, there are some sixty-six types of foreign obligations alone, including such names as "external," "internal," "customs lien," and "stabilization" bonds.

BONDS IN TRUST PORTFOLIOS.—The traditional theory that bonds are an important form of investment was clearly adhered to by the trust institutions under study. The average investment in bonds for the composite group for fourteen years, 1919 to 1932, was 28.9 per cent. Bonds constituted 17.1 per cent of the 196 trusts when they were received by the trust institutions. By 1919, the proportion had been increased to 22.9 per cent. The trend in these securities from 1919 to 1924 was upward, rising to 31.1 per cent. From 1924 to 1928, however, it declined, but rose again through 1929 and 1932, reaching 34.3 per cent in the latter year. The fluctuations in the proportions carried in bonds were primarily due to the variations in government bonds. They showed a substantial gain, rising from 8.9 per cent in 1919 to 17.2 per cent in 1932. Corporate bonds showed a rather constant but moderate increase throughout, primarily because of the increase in holdings of utility bonds.

Bonds constituted a particularly important percentage of the fiduciary investments of the New York trust institutions. In 1919, they amounted to only 25.0 per cent of the total, but in 1932 the proportion had risen to 48.3 per cent, chiefly because of the increase in state and municipal bonds. Boston, likewise showed an increase in the investments allocated to bonds, increasing the proportion from 19.5 per cent in 1919 to 41.4 per cent in 1932. Chicago, on the other hand, slightly decreased the proportion in bonds from 28.7 per cent in 1921 to 28.6 per cent in 1932. The percentage of bonds held by the Cleveland trust institutions was also decreased, except in 1931 and 1932, when there was a pronounced rise. In 1921, the proportion was 10.8 per cent;

in 1930, 10.9 per cent; but in 1932 it stood at 20.2 per cent. St. Louis throughout retained about the same proportion in bonds, at slightly over 20 per cent. From these figures it is seen that New York carried the largest proportion in bonds and Cleveland the smallest. Certainly, the trust institutions followed no uniform policy in the different cities.

There were wide differences in the bond holdings of individual trusts (see Table XXVII). During the last year for which data were collected ten trusts held over 50 per cent of their assets in one type of bond. Thirty-two trusts held from 25 to 50 per cent in one type. A few trusts listed no bonds in their portfolios. In others the proportion ranged from a small per cent to approximately 100 per cent.

PREFERRED STOCKS.—Preferred stock represents ownership in a corporation. It is like common stock except for certain preferences or limitations which it may contain, as specified in the charter or by-laws. Preferred stock is so labelled because it is given certain priorities over the common. The preference position of such stock is nearly always with respect to income; frequently it is also preferred as to assets. Although preferred stocks, as a group, have more investment risks than bonds, their position is superior to that of common stocks. They offer certain investment advantages and appeal to those investors who seek a higher return than bonds afford.

It is true that preferred stocks have certain objectionable features as an investment in that they do not bear the position of creditor, like bonds, nor do they have the possibilities, unless participating, of enjoying the advantage of full ownership. In many cases, however, in which companies have issued no bonds, preferred stocks hold a position similar to bonds with regard to a prior claim upon property and income. Thus, where preferred stocks are not subordinate to prior bond liens, or are subordinate only to very small issues, and represent substantial industries, they may deserve a high investment rating.

There are various types of preferred stock, though they are not so numerous as bonds. Some twenty-three types go to make up this group of stocks; they appear under such titles as: "preferred as to dividends," "preferred as to dividends and assets," "cumulative," "non-cumulative," "first preferred," "second preferred," "callable," "non-callable," "participating," "voting," "non-voting," and "convertible."

INVESTMENT IN PREFERRED STOCK.—Preferred stock as a composite investment in the trusts showed a fairly steady decrease from 7.9 per cent in 1919 to 4.4 per cent in 1932, averaging 6.6

per cent for the fourteen years. Industrial preferred stocks constituted more than 50 per cent of this group. These securities showed little change in Boston and Chicago for the entire period, but steadily decreased in the other cities.

Among the individual trusts a fairly large number exhibited no preferred stock at the end while a small number contained over 50 per cent in these securities. In general, the trusts holding preferred stocks, showed a relatively small percentage of their assets so invested.

COMMON STOCKS.—Common stock represents an unrestricted ownership in a corporation. It is a "residual" ownership, however. That is, common stock has a right in the assets and earnings after prior claims represented by bonds and preferred stocks have been met. They also assume all the hazards incidental to ownership. Thus, common stocks stand in a position to receive almost unlimited profits or to incur total loss. They offer a number of attractive features to the investor, growing out of price changes, trends in industry, and corporate policies of reinvesting earnings.

Common stocks do not differ in type so greatly as do bonds or even preferred stocks. Yet there are some thirteen different kinds including "par value" or "non-par value," "voting" or "non-voting," usually designated as "class A" and "class B."

COMMON STOCK IN TRUST PORTFOLIOS.—Common stocks were received in trust from the grantor primarily rather than by deliberate purchase. They constituted 38.5 per cent of the trusts' assets in the inventory. The figure had dropped to 35.0 per cent in 1919 and to 30.7 per cent in 1926. From 1926 to 1931 there was a rise in this group, the proportion becoming 34.2 per cent in 1929. By 1932 the proportion in common stocks had declined to 32.4 per cent. For the fourteen years, 1919 to 1932, common stocks averaged 33.2 per cent and were relatively the largest class of investment in the composite fund except bonds.

The trust institutions in each of the five cities decreased the proportion allocated to common stocks as compared with the total received in the principal from the grantor. As a group the New York trusts contained the smallest percentage of common stocks; this percentage was reduced nearly two-thirds by 1932. The other cities showed less change in common stocks.

The individual trusts again showed wide differences in the percentage invested in these securities, varying from none in some accounts to over 75 per cent in others. (See Table XXVII.)

REAL ESTATE OBLIGATIONS.—Real property as security for long-term loans is probably the oldest and most popular form of

investment in the United States. Real estate obligations in some form, principally first mortgages, are legal in every state for trust investments, savings banks and other institutions. Their investment standing is traditional. The popularity of real estate obligations, however, should not influence one to select them without investigation. Such instrument varies in quality as greatly as do other types of investment. At best most of the real estate obligations have a comparatively slow market. Further, a majority of these instruments, especially mortgages, require a great deal of supervision. Only through careful selection and supervision are real estate mortgages to be considered a safe class of investment.

Real estate instruments consist of a great variety of securities besides the various classes of mortgages. They have been developed to include such names as the real estate mortgage bond which may be a first, second, third, etc., mortgage bond, collateral real estate mortgage bond, leasehold bond, guaranteed mortgage bond, debenture bond, mortgage participating certificates, guaranteed mortgage certificates, first mortgage leasehold and land trust certificates. Preferred and common stocks are also found in the real estate field, but they play a very minor rôle.

PROPORTION OF TRUST PRINCIPAL IN REAL ESTATE OBLIGATIONS.—Real estate obligations were the third largest class of investment, averaging 19.4 per cent of the principal of the 196 trusts for the period 1919-1932. This group of investments showed the most pronounced gain over the percentage contained in the inventory of any class in the composite assets. The data of Table X exhibit the following figures: inventory, 9.9 per cent; 1919, 16.5 per cent; 1930, 25.1 per cent; 1932, 24.3 per cent.

In each of the five states, the trust institutions placed a large percentage of the trust assets in real estate mortgages or bonds. These showed a substantial gain in New York, Cleveland, and St. Louis; only a slight increase in Chicago, and no increase in Boston. The Cleveland trust institutions were the only ones that contained land bank bonds, holding principally Joint Stock Land Bank bonds.

The individual trusts showed wide differences in their policy with respect to investing in real estate obligations. One hundred and sixty-eight accounts had some of their principal so invested in the last year for which data were collected. Of this number, twenty-nine held over 75 per cent in this class of investment and twenty-eight held from 50 to 75 per cent. Twenty-one of the one hundred and sixty-eight trusts had less than 5 per cent in these investments.

REAL ESTATE.—The real estate holdings were all received in trust from the grantor. Consequently this item is not indicative of the investment policy of trust institutions. It is doubtful if real estate has a permanent place in a trust investment program.

Real property averaged 10.5 per cent of the composite assets for the period 1919 to 1932. It showed the most pronounced drop of any type of investment, decreasing from 18 per cent in the inventory to 17 per cent in 1919 and to 3 per cent in 1932.

In every city the trust assets containing real estate in amounts of any importance showed a gradual, but a substantial decrease in this item. New York trust institutions accounted for over 50 per cent of the total investments in real property. Ranking next to New York in their real estate investments were the Cleveland trust institutions.

Even after a long period of operation thirty-one trusts continued to held real estate as part of their portfolio. In eight of these accounts real estate proper constituted over 50 per cent of the principal. At the end of the trusts only 15 per cent contained real estate while in the inventory real estate was listed in nearly 29 per cent of the accounts.

SUMMARY.—During the period 1919 to 1932, bonds showed

TABLE XI

DISTRIBUTION OF INVESTMENTS BY CLASSES IN TRUST INSTITUTIONS AND LIFE INSURANCE COMPANIES, 1924-1932

Class of Investment	1924	1925	1926	1927	1928	1929	1930	1931	1932
TRUST COMPANIES									
	%	%	%	%	%	%	%	%	%
Bonds	31.1	29.7	28.2	26.9	26.6	28.3	29.4	32.8	34.3
Preferred Stock	7.4	7.4	6.9	6.3	5.4	5.9	6.0	4.4	4.4
Common Stock	33 6	31.9	30.7	31.4	33.2	34.2	33.4	33.3	32.4
Real Est. Oblig.	14.8	18.7	19.9	21.3	21.9	24.5	25.1	24.8	24.3
Real Estate	11.8	11.8	11.4	11.0	8.8	6.2	5.1	3.8	3.0
Miscellaneous	1.3	0.5	2.9	3.1	4.1	0.9	1.0	0.9	1.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
LIFE INSURANCE COMPANIES[a]									
	%	%	%	%	%	%	%	%	%
Bonds	40.6	39.4	37.4	37.1	36.6	35.2	34.8	34.8	34.0
Preferred Stock	0.1	0.1	0.1	0.2	0.8	1.5	2.1	2.2	2.2
Common Stock	0.6	0.6	0.6	0.5	0.4	0.5	0.6	0.5	0.6
Real Est. Oblig.	39.6	41.1	43.0	43.1	42.5	42.0	40.5	38.4	36.3
Real Estate	1.8	1.8	1.8	1.9	2.1	2.2	2.4	2.8	4.0
Miscellaneous	17.3	17.0	17.1	17.2	17.6	18.6	19.6	21.3	22.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

[a] *Proceedings of the Twenty-sixth Annual Convention of the Association of Life Insurance Presidents,* (1932), pp. 108-9.

a substantial increase; real estate obligations made a considerable gain; preferred stocks dropped a good deal; real estate decreased heavily; and common stocks maintained approximately their relative position.

COMPARATIVE DISTRIBUTION OF INVESTMENTS ACCORDING TO CLASSES IN TRUST INSTITUTIONS AND LIFE INSURANCE COMPANIES, 1924-1932.—In Table XI on page 159 is presented the diversification of investments by classes in trust institutions compared with life insurance companies.

Life insurance companies show a definite decrease in bonds and real estate obligations. There was an increase, however, in the proportion allocated to government bonds during the depression period. Railroad bonds declined from 21.7 per cent in 1924 to 15.6 per cent in 1932. All other bond groups of any importance except United States bonds showed an increase during the same period. The decreases in bonds and real estate obligations were offset by the gains in policy loans and premium notes, and in real estate. Policy loans and premium notes, included in miscellaneous, increased from 12.3 per cent in 1924 to 18.4 per cent in 1932. Life insurance companies also increased the percentage in preferred stocks.

In comparison trust institutions increased bonds and real estate obligations but decreased preferred stocks and real estate.

DISTRIBUTION OF TRUST INVESTMENTS ACCORDING TO CLASSES IN TRUST INSTITUTIONS COMPARED WITH NATIONAL BANKS, 1932.—The distribution of trust investments in trust institutions and in national banks, according to classes is shown in Table XII.

TABLE XII

COMPARATIVE DISTRIBUTION OF TRUST INVESTMENTS BY CLASSES IN TRUST INSTITUTIONS AND NATIONAL BANKS, 1932

Classes of Investment	Trust Institutions[a]	National Banks[b]
Bonds	34.3%	37.6%
Stocks	36.8	30.9
Real Estate Oblig.	24.3	16.1
Miscellaneous	4.6	15.4
Total	100.0	100.0

[a] See Table X.

[b] *Annual Report of the Comptroller of the Currency*, 1932.

Although there were differences in the proportions allocated to the different classes of investment these variations are probably explained by the fact that the trusts being administered by trust institutions had been in existence thirteen years or longer while the trust investments of the national banks represent a cross section of the different trusts, irrespective of the time they had been in existence.

COMPARATIVE DISTRIBUTION OF INVESTMENTS BY CLASSES IN VARIOUS INSTITUTIONS.—A further comparison of investments of trust institutions with other institutions is exhibited in Table XIII on page 162.

It is interesting to note that the trust institutions held a larger proportion of bonds than was held by other institutions except commercial banks. Likewise, the trust institutions contained next to the largest percentage in common stocks, being exceeded only by the fire insurance companies. This difference is largely due to the fact that the trust institutions received a substantial portion of the trust assets in the form of common stocks. It is doubtful if their policy in choosing this type of investment differed radically from that of the other institutions. The trust institutions in Boston, however, did invest a considerable portion of their trust funds in stocks as a matter of choice. The Cleveland institutions also purchased some common stocks. In general, trust institutions, life insurance companies and savings banks have been barred in most states from selecting stocks by statutory law. For the most part, however, fire insurance companies have labored under no such restrictions; hence their distribution of investment should conform more nearly to the ideal practice.

As for real estate obligations, the trust institutions contained less than did either life insurance companies or savings banks. Fire insurance companies and commercial banks did not list real estate obligations separately, if they contained any.

DISTRIBUTION OF INVESTMENTS BY CLASS IN TRUSTS GROUPED ACCORDING TO SIZE.—The distribution of trust assets, with respect to class of investment, in trusts classified according to size, is exhibited in Table XIV, as shown on pages 164-165, for each year, 1919 to 1931. Each group of accounts is a composite of all the trusts from each city within the size limits specified.

The data show that the proportion in bonds was not greatly different in the various groups of trusts. The trends of investment, however, in the different classes were dissimilar. The trusts ranging from $0 to $25,000 decreased the proportion in bonds, while the group of $1,000,000, or over, increased the per-

TABLE XIII

COMPARATIVE DISTRIBUTION OF INVESTMENTS BY CLASSES IN TRUST INSTITUTIONS, LIFE INSURANCE COMPANIES, FIRE INSURANCE COMPANIES, COMMERCIAL BANKS AND NEW YORK SAVINGS BANKS FOR 1932

Class of Investment	Trust Institutions[a]	Life Insurance companies[b]	Fire Insurance Companies[c]	Commercial Banks[d]	N. Y. Savings Banks[e]
Bonds[f]	34.3%	34.0%	33.9%	77.5%	32.1%
Preferred Stock	4.4	2.2	12.7	4.0	0.0
Common Stock	32.4	0.6	37.4	0.0	0.0
Real Estate Oblig.....	24.3	36.3	1.2	0.0	60.4
Real Estate	3.0	4.0	2.6	0.0	0.0
Miscellaneous	1.6	22.9	12.2	18.5	7.5
Total	100.0	100.0	100.0	100.0	100.0

[a] See Table X.

[b] Based on fifty-two legal reserve life insurance companies, 1932. See Table XI.

[c] Based on ten of the largest fire insurance companies. Source: *Best's Insurance Reports—Fire and Marine*, 1933.

[d] *Annual Report of the Comptroller of the Currency*, 1932.

[e] *Report of the Superintendent of Banks*, 1933.

[f] Does not include real estate or land bank bonds.

centage allocated to this class of investment. The group from $75,000 to $200,000 also reduced the proportion carried in bonds. The $500,000 to $1,000,000 class decreased the amount in bonds for 1919 to 1922, but thereafter substantially increased this item.

This trend was reversed for bond holdings in the trusts ranging from $200,000 to $500,000. In the group from $25,000 to $75,000 there was a slight increase in the proportion contained in bonds.

Preferred stock showed about the same movement in all the groups below $1,000,000. In these groups there was a small gain in the proportion carried in preferred stocks for the first two or three years, but a gradual decrease thereafter. There was a constant decline in the percentage contained in this class of investment in the largest group. This type of investment constituted a smaller proportion of the assets in the group of trusts of $1,000,000 or over than of any other group.

The percentage in common stocks was decreased in the classes of accounts below $75,000 in size. The proportion in this class of investment, however, was not appreciably changed in the four groups of trusts ranging above $75,000. Common stocks constituted the largest proportion of the investment in the class of $1,000,000 or over. They amounted to 15 per cent or more in each group, being exceeded by bonds and real estate obligations in the groups below $200,000 in size.

Real estate obligations were contained in the largest proportions in the trusts below $200,000. The trend of investment in this item was uniformly the same in all the groups. Each group showed a gain in this class of investment from 1919 to 1932, although there was a decrease for the first few years—except in the trusts ranging from $500,000 to $1,000,000.

All the groups less than $500,000 in size held a small proportion of their investments in real estate proper. Each of these groups showed a definite decrease in this item throughout the period, 1919-1932. While this class of investment ranked proportionately large in the groups above $500,000—especially in the trusts from $500,000 to $1,000,000—the trend was the same as in the preceding groups.

Apparently the trust institutions followed a definite policy with respect to real estate proper and real estate obligations. However, it is practically impossible to tell whether the differences in the other classes of investment in the several groups were due primarily to the contents of the trusts at the time when they were received or to a planned policy on the part of the trust institutions.

TABLE XIV

RELATIVE DISTRIBUTION OF INVESTMENTS ACCORDING TO CLASSES IN TRUSTS GROUPED BY SIZES FOR EACH YEAR, 1919-1931

No. of Trusts	Size	Class of Investment	1919 %	1920 %	1921 %	1922 %	1923 %	1924 %	1925 %	1926 %	1927 %	1928 %	1929 %	1930 %	1931 %
		Bonds	29.6	30.6	32.8	31.9	32.6	29.3	25.6	26.1	19.3	18.8	17.6	16.8	17.4
		Preferred Stocks	8.5	9.1	10.6	13.0	12.5	11.2	10.7	10.4	9.7	9.4	11.7	12.8	12.6
	0	Common Stocks	28.4	26.7	26.1	26.6	25.1	23.7	23.7	23.2	23.3	23.5	23.7	23.6	23.7
36	to	Real Estate Obligations	28.3	27.3	25.0	23.1	25.8	31.5	37.7	38.0	44.4	46.1	45.0	44.6	44.1
	25,000	Real Estate	4.8	5.0	5.0	4.2	3.0	2.2	1.3	1.2	1.2	1.1	1.2	1.0	0.8
		Miscellaneous	0.4	1.3	0.5	1.2	1.0	2.1	1.0	1.1	2.1	1.1	0.8	1.2	1.4
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Bonds	22.5	24.3	25.3	24.6	25.7	25.8	26.4	26.6	25.7	25.8	24.7	24.8	25.2
		Preferred Stocks	9.8	13.8	14.3	13.2	13.5	13.6	12.3	11.5	10.4	12.8	12.7	13.8	13.8
	25,000	Common Stocks	22.1	21.4	20.5	17.3	16.4	16.8	13.8	13.0	11.9	12.1	12.0	11.8	11.4
50	to	Real Estate Obligations	34.1	31.0	30.0	35.3	38.9	38.5	42.5	43.9	47.0	43.3	42.0	41.6	41.4
	75,000	Real Estate	9.6	9.3	8.9	8.2	4.2	4.1	4.1	4.1	4.1	4.7	5.7	4.4	4.3
		Miscellaneous	1.9	0.2	1.0	1.4	1.3	1.2	0.9	0.9	0.9	1.3	2.9	3.6	3.9
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Bonds	33.7	33.7	35.1	33.6	33.4	32.6	28.3	27.1	26.0	22.3	26.2	25.5	25.8
		Preferred Stocks	7.3	8.9	9.4	9.6	9.9	9.2	9.1	9.2	8.7	7.2	7.7	8.1	8.0
	75,000	Common Stocks	18.6	19.8	18.8	18.0	18.0	18.6	19.7	19.6	18.4	20.0	22.1	22.5	22.1
42	to	Real Estate Obligations	29.2	26.8	27.0	29.5	30.4	31.7	35.2	35.4	38.9	41.7	39.0	37.3	37.5
	200,000	Real Estate	8.6	8.2	8.1	7.3	7.4	7.4	7.0	7.5	7.6	7.6	3.8	4.1	3.7

No. of Trusts	Size	Class of Investment	1919 %	1920 %	1921 %	1922 %	1923 %	1924 %	1925 %	1926 %	1927 %	1928 %	1929 %	1930 %	1931 %
		Miscellaneous	2.6	2.6	1.6	2.0	0.9	0.5	0.7	1.2	0.4	1.2	1.2	2.5	2.9
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Bonds	27.0	27.0	30.9	31.9	36.3	38.7	36.3	35.7	31.8	29.9	27.5	25.5	25.6
		Preferred Stocks	6.3	7.7	10.5	10.1	9.7	9.3	9.6	9.2	8.8	6.5	7.8	6.7	6.6
	200,000	Common Stocks	37.3	35.9	35.1	34.6	31.4	28.6	27.1	26.3	32.8	32.3	35.4	35.6	37.0
42	to	Real Estate Obligations	22.7	20.3	15.7	14.9	15.5	17.2	19.9	22.4	22.5	25.8	25.0	24.7	24.6
	500,000	Real Estate	4.6	4.8	5.2	4.7	4.1	3.8	3.7	3.4	2.9	3.3	2.9	3.0	2.8
		Miscellaneous	2.1	4.3	2.6	3.8	3.0	2.4	3.4	3.0	1.2	2.2	1.4	4.5	3.4
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Bonds	30.1	29.4	24.8	22.8	23.1	25.9	28.3	28.4	31.2	35.5	35.0	34.3	34.7
		Preferred Stocks	5.1	5.2	5.5	5.4	6.6	6.7	6.3	6.1	5.8	6.0	5.0	5.0	4.8
	500,000	Common Stocks	24.8	26.3	26.6	28.9	29.2	28.8	26.6	25.8	24.9	25.4	27.8	27.9	27.2
10	to	Real Estate Obligations	3.1	3.1	4.4	5.1	6.8	7.9	10.0	10.2	10.6	10.0	11.8	11.9	12.1
	1,000,000	Real Estate	35.7	35.6	37.9	37.4	33.8	30.1	28.5	28.4	27.3	22.5	20.0	19.3	18.5
		Miscellaneous	1.2	0.4	0.8	0.4	0.5	0.6	0.3	1.1	0.2	0.6	0.4	1.6	2.7
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Bonds	17.7	18.9	28.6	30.9	30.6	31.0	28.4	27.5	25.8	25.4	28.7	30.2	30.8
		Preferred Stocks	6.1	5.6	5.9	5.7	5.0	4.6	4.5	4.4	3.3	3.2	3.6	4.1	3.8
	1,000,000	Common Stocks	39.0	39.6	37.3	39.4	41.4	41.1	38.8	38.7	36.0	36.5	38.6	37.8	37.5
16	or	Real Estate Obligations	12.8	11.9	9.5	6.4	6.5	7.1	11.8	13.1	15.2	17.8	22.0	20.9	20.8
	over	Real Estate	22.9	22.8	18.1	17.0	14.9	14.7	14.8	14.9	17.1	12.5	5.1	5.2	5.1
		Miscellaneous	1.5	1.2	0.6	0.6	1.6	1.5	1.7	1.4	2.6	4.6	2.0	1.8	2.0
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Chapter XI

INVESTMENTS OF TRUST INSTITUTIONS—DIVERSIFICATION ACCORDING TO FIELDS

IN this Chapter we shall consider how trust institutions distributed the principal of the trusts according to fields from 1919 to 1932. We shall first note the division of investments according to broad classes, comprising the following fields: governmental obligations, corporate securities, real estate and real estate obligations, and miscellaneous. In Table XV is shown the percentage distribution of investments in these broad groups for the inventory of the trusts, and for the years 1919, 1926 and 1932.

TABLE XV

DIVISION OF INVESTED ASSETS OF 196 TRUSTS INTO GENERAL FIELDS OF INVESTMENT

Field of Investment	Inventory	1919	1926	1932
Governmental	6.9%	9.4%	13.9%	17.7%
Corporate	55.5	56.4	51.9	53.4
Real Estate	27.9	33.5	31.3	27.3
Miscellaneous	9.7	0.7	2.9	1.6
Total	100.0	100.0	100.0	100.0

It is quite evident from the foregoing data that trust investments depend primarily upon corporate enterprises rather than upon real estate or governmental units. The trust institutions made only minor changes in the proportion allocated to the corporate field. The percentage in governmentals showed a substantial increase, while the real estate group decreased considerably from 1919 to 1932. This change was due to the pronounced decrease in real estate proper.

A further and more detailed study of the investments may be made by analyzing the component parts of these broad fields. Governmental obligations may be divided into three classes: those issued by the Federal Government; those issued by municipalities and districts within the United States; and those issued by foreign governments and various political subdivisions outside the country. Corporate securities are usually divided into the following groups: railroad, utility, industrial, bank and insurance. Real estate investments are classified as mortgages, mortgage

bonds, and real property. Miscellaneous includes all other items, chiefly cash. The percentage of the total assets of the 196 trusts invested in each field for each year 1919 to 1932 is exhibited in Table XVI on page 168. These data are shown graphically in Chart V on page 169.

GOVERNMENTAL INVESTMENTS. United States government bonds are the best of all investments from the standpoint of safety and marketability. They represent the nearest approach to pure investment. Although they are not secured by a specific lien on property, they are direct obligations of the government. There is little question of their investment position as the government commands the taxing power over a rich nation. However, their yield is correspondingly low. In the light of these characteristics, it is interesting to note to what extent the trust institutions favored these securities for their trust portfolios. When the trust institutions received the property, fifty-nine of the one hundred ninety-six trusts contained United States government bonds. In the last year of accounting for which data were collected these securities were listed in seventy-three of the 196 accounts. The percentage of the composite assets so invested was quite small. United States government bonds constituted only 2.9 per cent of the inventory, and never exceeded 5.7 per cent at the maximum in 1921, when they were bought most freely in a depressed market. From 1928 to 1932, the percentage rose from 1.3 per cent to 3.1 per cent.

Until recently, state and muncipal bonds ranked next to United States government obligations. While state bonds for the most part continue to hold a high position as sound investments, many municipal securities have lost ground, and are of doubtful quality. The tax-exempt feature of this type of security is valuable only to the larger accounts. Their low return and somewhat limited marketability have apparently excluded them from trust portfolios. In the inventory, only forty-four trusts contained these bonds, and in the last year of accounting they were held by sixty-one trusts. They constituted only 3.5 per cent of the composite fund in the inventory. In 1919 the percentage had grown to 5.9, and by 1922, it had become 10.6 per cent. There was little change in this item from 1922 to 1929, but it rose to 14.1 per cent in 1932.

Foreign government bonds played a minor part in the trust portfolios, the composite assets showing less than 1 per cent in this field. There were few purchases of foreign bonds; practically the entire amount was received in trust from the grantor.

Throughout the fourteen years governmentals comprised a

TABLE XVI

RELATIVE DISTRIBUTION OF TRUST INVESTMENTS OF 196 TRUSTS ACCORDING TO FIELDS IN EACH YEAR, 1919-1932

Field of Investment	Inventory	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932	Average
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
Government	6.9	9.4	11.3	16.5	16.3	16.5	16.5	15.3	13.9	12.4	12.2	13.2	13.9	16.7	17.7	14.4
Railroad	18.4	21.9	21.3	19.5	18.7	17.5	17.2	16.8	16.5	16.3	13.8	10.0	9.4	7.9	7.5	15.3
Utility	11.8	11.6	11.4	10.6	9.8	9.7	10.3	9.4	9.0	8.9	9.7	11.5	11.8	11.9	12.5	10.6
Industrial	19.3	18.5	18.1	20.3	22.4	24.5	24.1	23.5	22.7	23.3	25.8	28.7	28.8	29.4	29.3	24.3
Finance	6.0	4.4	4.4	4.3	4.3	4.1	4.0	4.0	3.7	3.7	3.7	5.0	4.9	4.6	4.1	4.2
Real Estate	27.9	33.5	32.8	28.4	27.5	27.1	26.6	30.5	31.3	32.3	30.7	30.7	30.2	28.6	27.3	29.8
Miscellaneous	9.7	0.7	0.7	0.4	1.0	0.6	1.3	0.5	2.9	3.1	4.1	0.9	1.0	0.9	1.6	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

CHART V

RELATIVE DISTRIBUTION OF TRUST INVESTMENTS OF 196 TRUSTS BY FIELDS IN EACH YEAR, 1919-1932

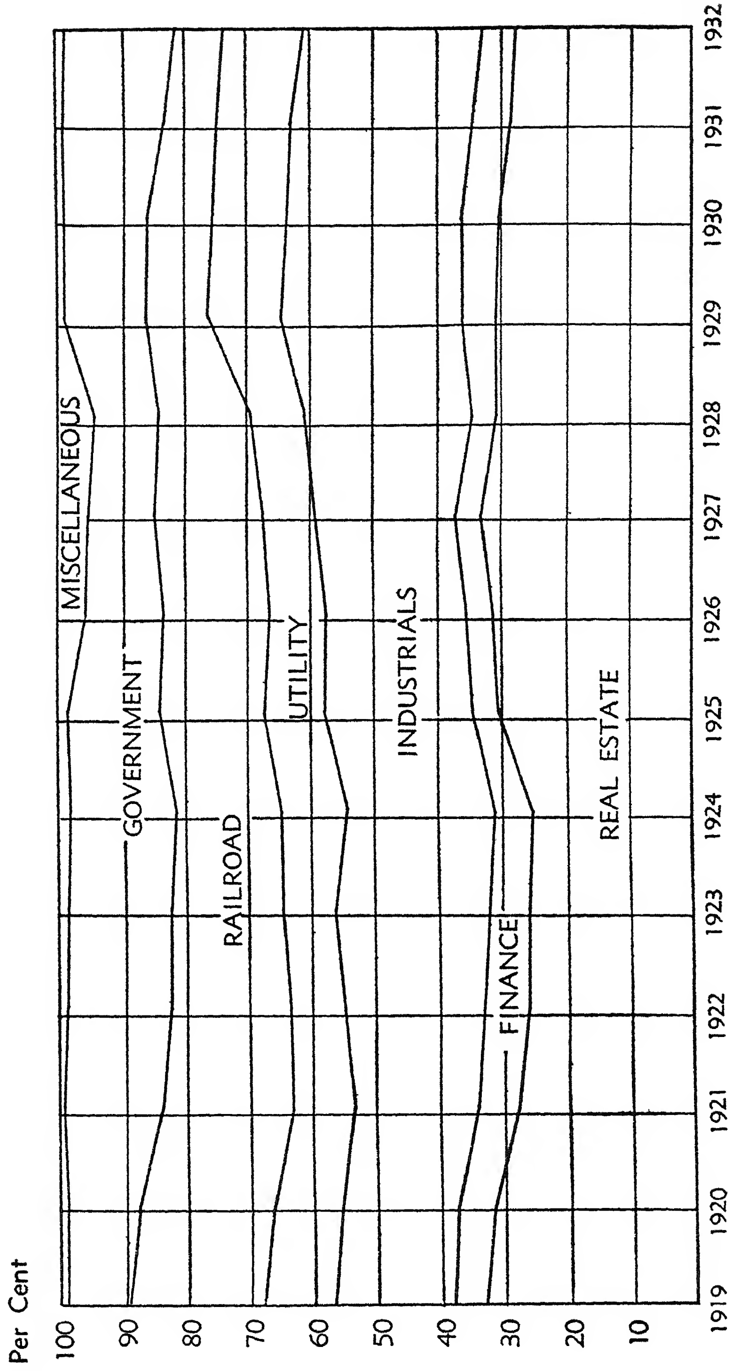


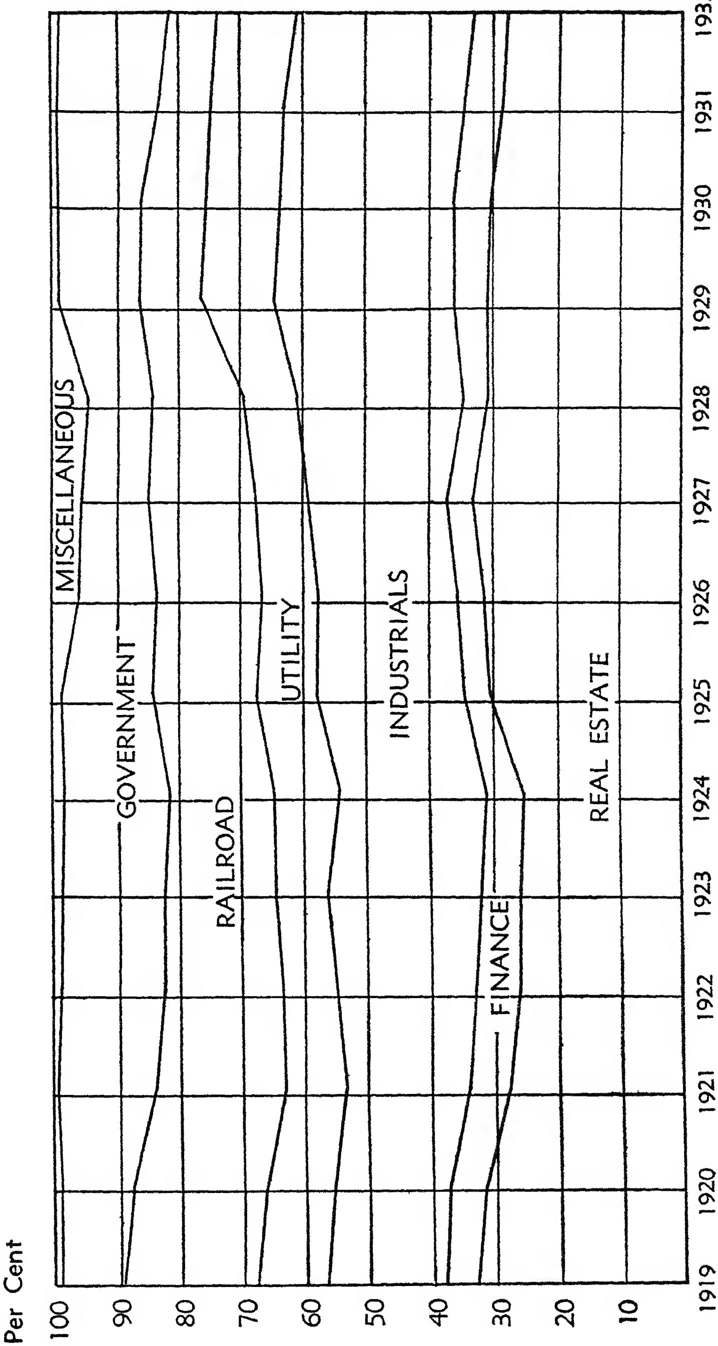
TABLE XVI

RELATIVE DISTRIBUTION OF TRUST INVESTMENTS OF 196 TRUSTS ACCORDING TO FIELDS IN EACH YEAR, 1919-1932

Field of Investment	Inventory	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932	Average
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
Government	6.9	9.4	11.3	16.5	16.3	16.5	16.5	15.3	13.9	12.4	12.2	13.2	13.9	16.7	17.7	14.4
Railroad	18.4	21.9	21.3	19.5	18.7	17.5	17.2	16.8	16.5	16.3	13.8	10.0	9.4	7.9	7.5	15.3
Utility	11.8	11.6	11.4	10.6	9.8	9.7	10.3	9.4	9.0	8.9	9.7	11.5	11.8	11.9	12.5	10.6
Industrial	19.3	18.5	18.1	20.3	22.4	24.5	24.1	23.5	22.7	23.3	25.8	28.7	28.8	29.4	29.3	24.3
Finance	6.0	4.4	4.4	4.3	4.3	4.1	4.0	4.0	3.7	3.7	3.7	5.0	4.9	4.6	4.1	4.2
Real Estate	27.9	33.5	32.8	28.4	27.5	27.1	26.6	30.5	31.3	32.3	30.7	30.7	30.2	28.6	27.3	29.8
Miscellaneous	9.7	0.7	0.7	0.4	1.0	0.6	1.3	0.5	2.9	3.1	4.1	0.9	1.0	0.9	1.6	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100 0	100.0	100.0

CHART V

RELATIVE DISTRIBUTION OF TRUST INVESTMENTS OF 196 TRUSTS BY FIELDS IN EACH YEAR, 1919-1932



fair proportion of the investments of the 196 trusts. They increased from 9.4 per cent in 1919 to 17.7 per cent in 1932, the most pronounced gain appearing during the depression years.

Among the individual trusts many carried no government securities, and those listing this type of investment held but a relatively small proportion of their principal in such securities. However, a few accounts had a large amount of their assets so invested. State and municipal bonds comprised over 50 per cent of three trusts and between 25 per cent and 50 per cent of six others.

RAILROAD OBLIGATIONS. For decades railroad bonds have been virtually "standard" investments. They have long been a major factor in the portfolios of life insurance companies, savings banks, and many other conservative institutions. Obviously, trust institutions, too, have an important stake in this field. When the property of the 196 trusts was handed over to the trust institutions, railroad obligations constituted 18.4 per cent of the total assets. The proportion in rails was increased to 21.9 per cent in 1919, but thereafter, it steadily decreased, every type of railroad security showing this declining trend from 1919 to 1932.

The stake of various institutional investors in railroad obligations is large. It is estimated that nearly 60 per cent of the $11,835,523,146[1] railroad bonds, or about $6,866 million, are owned by institutions.[2] Life insurance companies have $2,866,000,000, or 15.1 per cent of their resources in railroad bonds;[3] mutual savings banks have $1,700,000,000; commercial banks have $1,016,000,000; educational organizations have $176,000,000; other institutions own $1,108,000,000.[4] In addition to these large institutional holdings, it is estimated that over 900,000 individuals own $7,000,000,000 par value of railroad stocks, as well as several billion dollars worth of railroad bonds.[5]

Although the data show that trust institutions placed less than 20 per cent of their trust assets in railroad obligations, and constantly decreased the proportion, the present depressed state of the railroads is regarded as serious for the investor in this type of security.

The New York portfolios held a relatively large proportion

[1] Interstate Commerce Commission's annual report, 1933.

[2] Jones, John Price, "Our Stake in the Railroads," *Barrons,* Feb. 29, 1932, p. 8.

[3] *Proceedings of the Twenty-Sixth Annual Convention of the Association of Life Insurance Presidents,* (1932), p. 108.

[4] Jones, *op. cit.*

[5] Wood, Struthers & Company, *Trusteeship of American Endowments,* (1932), p. 41.

in the rail group, both in bonds and common stocks. The latter, however, were not purchased by New York trust institutions themselves, but were received from the grantor. The proportion allocated to rails showed a gain in Boston, but a decrease in all other cities.

The last year for which data were collected showed that six trusts contained over 50 per cent of their principal in railroad bonds while nine had between 25 per cent and 50 per cent so invested. Four portfolios also held 25 per cent to 50 per cent in railroad common stocks. For the most part, however, the trusts containing rails held a rather small percentage in this field.

PUBLIC UTILITY SECURITIES. One of the significant developments in the investment market during the past decade has been the rise of the securities of public utility companies to a position comparable to that long enjoyed by railroads. The obligations of sound, well-managed and properly capitalized public utility corporations have withstood the depression exceedingly well. This is especially true of the light and power companies. The obligations of the operating companies, engaged primarily in the electric field, have a most favorable record as sound investments. Many of the securities within the past seven years have been made legal investments in Massachusetts, New York, New Jersey, and Connecticut. The bonds of the American Telephone and Telegraph Company and its constituent companies, are also ranked among the prime investments of the country. However, the belated recognition given to these instruments by our legislators has precluded them to a large extent, except in recent years, from investment for trust funds. However, the proportion allocated to utilities as a class showed some increase. The gain was due to utility bonds, as stock decreased. The percentage of investments in this field was shown to be 11.8 per cent in the inventory. It dropped to 8.9 per cent in 1927, but thereafter rose to 12.5 per cent in 1932. Utility bonds showed a fairly steady rise throughout. In the respective cities, Boston and St. Louis increased the percentage in utilities, while New York, Chicago and Cleveland decreased their investments in this field. The proportion in utility bonds, however, was increased in each city.

There were wide differences in policies of individual trusts with respect to utility investments. A goodly number held no utility securities at any time. Many others selected only a small proportion of these investments. At the end fifteen trusts contained from 25 per cent to 50 per cent in utility bonds, four held this proportion in utility preferred stocks and three showed the

same amount in common stocks. Only one trust contained over 50 per cent in utility securities.

INDUSTRIAL SECURITIES. The industrial field covers a wide list of industries, representing hundreds of forms of business, so that it is exceedingly difficult to survey this group accurately or completely. Lack of standardized practices in accounting and in the rendering of reports further complicates the situation. The railroads and public utilities have definite accounting systems and uniform regulatory measures applied by either federal or state government. These factors facilitate a close scrutiny over earnings. The industrial field has no such uniform regulation nor accounting practices, and the competitive conditions under which industrials operate make it difficult for any but the strongest to survive.[6] Consequently, business risks in this field are necessarily higher.[7] But on the other hand, the opportunities for growth and profit are considerable, probably superior to those offered by railroads and public utilities.

It is most interesting to observe that despite the more or less speculative nature of industrial securities, the industrial group constituted a larger proportion of trust investments than either rails or utilities. They were exceeded only by real estate and real estate obligations as a composite. In the inventory, industrial securities constituted 19.3 per cent of the total assets. This group showed a substantial increase from 1919 to 1932, rising from 18.5 per cent to 29.3 per cent. Common stocks were the predominant element of the industrial group, and their appreciation accounted primarily for the increased percentage shown in this field.

Trust institutions in Chicago and Cleveland increased the proportion of their holdings in the industrial field, but in the other cities this group showed a decrease. Chicago and Cleveland contributed over 50 per cent of the aggregate investment in industrial common stock.

Large industrial holdings were due primarily to the rôle of industrial common stocks. At the end, this item comprised over 75 per cent of two accounts and from 50 per cent to 75 per cent in two others. Sixteen trusts contained between 25 per cent and 50 per cent in these stocks. Industrial preferred stock composed

[6] Other factors are instability of demand, changes in style, tastes, business conditions, etc.

[7] While in general, industrial corporations are subject to high business risks, there are exceptions. For instance, such concerns as the Aluminum Company of America, Eastman Kodak, and the Texas Gulf Sulphur Company, which are essentially monopolies.

over 50 per cent of the investment of two accounts and from 25 per cent to 50 per cent of three other accounts.

REAL ESTATE INVESTMENTS. Real estate in some form is an important part of the investments of life insurance companies, savings banks, universities and colleges, and many other institutions. Life insurance companies in 1932 had 40.3 per cent in real estate, 36.3 per cent being in mortgages, and 4.0 per cent in real estate proper. Savings banks had an even larger proportion so invested. American universities and colleges in 1931 had 27.4 per cent invested in real estate,[8] slightly over one-half being in real estate bonds or mortgages, largely the latter. This type of investment constitutes the largest single class in the trust portfolios.

The beginning of the trusts showed an aggregate of 27.9 per cent in this item. By 1919, the proportion had increased to 33.5 cent, but for the next few years, the percentage dropped, being 26.6 per cent in 1924. From this point the proportion was increased again, standing at 27.3 per cent in 1932. The separate items in the real estate group showed the following trends: real property dropped steadily throughout; real estate obligations decreased from 16.5 per cent in 1919 to 13.0 per cent in 1924. From this point, however, there was a substantial rise in the proportion allocated to this item, which reached 22.3 per cent in 1932. Land bank bonds also made an appreciable gain.

At the end of the period studied real estate obligations were an investment selection in 168 of the 196 trusts. This type of investment comprised over 75 per cent of the principal in twenty-nine trusts, and made up 50 per cent to 75 per cent in twenty-eight other accounts. Twenty-nine other trusts also had from 25 per cent to 50 per cent so invested.

Real estate proper constituted 50 per cent or more of eight trusts and from 25 per cent to 50 per cent of four others.

The New York trust institutions carried the greatest proportion in real estate (real estate and real estate obligations). The average was approximately 45 per cent for the fourteen years, 1919 to 1932. Real estate obligations showed a pronounced gain rising from 25 per cent in 1919 to about 54 per cent in 1932.[9] In the Boston trusts the percentage in both real estate and real estate obligations decreased. Real estate obligations were increased by the Chicago institution from about 16 per cent in the inventory to around 45 per cent in 1932. The Cleveland

[8] Wood Struthers & Co., *op. cit.* p. 60.

[9] These data are based on an average, counting each trust of equal weight. On a relative basis these figures would be considerably smaller.

trusts showed a substantial gain in real estate obligations also. When the trusts were received from the grantor, 7.9 per cent was in this investment while in 1932 it was about 25 per cent. Holdings in real estate proper were decreased by the Cleveland trust institutions. From 1921 to 1932 there was a decline in the proportion contained in the composite of real estate and real estate obligations. Real estate obligations were increased in the St. Louis accounts, the proportion rising from 14 per cent in the inventory to 28 per cent in 1931.

Around 80 per cent of the real estate obligations came from New York and Chicago; New York trust institutions contributed approximately 60 per cent of the total. Real estate proper was also supplied chiefly by the New York trusts.

Although real estate (chiefly real estate obligations) has been a favorite form of investment for trustees, its standing has been sharply shaken by the events of recent years. The general collapse in all forms of real estate is of major concern to all investors. It is estimated that a large percentage of all real estate obligations are in distress, the result of foreclosure, defaults, or non-payment of taxes. All told, several billion dollars worth of real estate obligations have been in default since the depression began. Traditional practices of selecting real estate securities are no longer satisfactory, but will have to be revised on a more scientific basis.

FINANCIAL INVESTMENTS.—Undoubtedly, the stocks of many well-managed banks and insurance companies constitute substantial investments. Their shares have represented a conservative medium for participating in the longer term growth of equities. Sagacity in the selection of these securities is highly important, however, and difficult. Bank and insurance stocks have not been to date an important element in the investments of institutions. The trust institutions studied contained a larger proportion of investments from this field than did insurance companies, savings banks, or leading universities and colleges. At the beginning 6.0 per cent of trust assets were invested in finance securities, principally bank stocks. This proportion, however, was decreased throughout, except for a few years. In 1932 it amounted to 4.1 per cent. This type of investment reached important proportions only in Cleveland and St. Louis.

COMPARATIVE DISTRIBUTION OF INVESTMENTS OF TRUST INSTITUTIONS AND LIFE INSURANCE COMPANIES BY FIELDS.—Table XVII shows the comparative distribution of assets according to the fields of investment of trust institutions and life insurance companies for each year, 1925 to 1932.

TABLE XVII

COMPARATIVE DISTRIBUTION OF INVESTMENTS OF TRUST INSTITUTIONS AND LIFE INSURANCE COMPANIES BY FIELDS, 1925-1932

TRUST INSTITUTIONS

Field of Investment	1925	1926	1927	1928	1929	1930	1931	1932
Government ...	15.3%	13.9%	12.4%	12.2%	13.2%	13.9%	16.7%	17.7%
Railroad	16.8	16.5	16.3	13.8	10.0	9.4	7.9	7.5
Utility	9.4	9.0	8.9	9.7	11.5	11.8	11.9	12.5
Industrial	23.5	22.7	23.3	25.8	28.7	28.8	29.4	29.3
Real Estate....	30.5	31.3	32.3	30.7	30.7	30.2	28.6	27.3
Miscellaneous .	4.5	6.6	6.8	7.8	5.9	5.9	5.5	5.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

LIFE INSURANCE COMPANIES[a]

Field of Investment	1925	1926	1927	1928	1929	1930	1931	1932
Government ...	11.9%	9.5%	8.6%	8.0%	7.9%	7.7%	8.3%	8.4%
Railroad	20.8	20.2	19.4	18.7	17.7	17.0	16.2	15.6
Utility	5.9	6.9	8.2	9.0	9.0	9.7	9.8	9.6
Industrial	1.5	1.5	1.6	2.1	2.6	3.1	3.2	3.2
Real Estate....	42.9	44.8	45.0	44.6	44.2	42.9	41.2	40.3
Miscellaneous .	17.0	17.1	17.2	17.6	18.6	19.6	21.3	22.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

[a] *Proceedings of the Twenty-Sixth Annual Convention of the Association of Life Insurance Presidents,* (1932), pp. 108-9.

From the above data, we note that the trend of trust institution investments in these broad fields, as compared with investments of life insurance companies, shows some similarity. The proportions in the various groups, however, show a wide variation. The widest difference seems to be in the industrial group, real estate, and miscellaneous. The trust institutions have a larger percentage invested in government bonds, and in utility and industrial obligations. Life insurance companies contain a larger percentage of rails, real estate, and miscellaneous.

COMPARISON OF INVESTMENTS OF TRUST INSTITUTIONS AND FIRE INSURANCE COMPANIES BY FIELDS.—Table XVIII on page 176 compares, with respect to the field of investment, the diversification of the principal of 196 trusts from nineteen trust institutions from five states with the combined investments of ten large fire insurance companies.

The figures clearly reflect the following differences: The trust institutions have larger investment in governmentals, industrials and real estate, the governmentals consisting principally of state and municipal bonds, the industrials of common stock, and the real estate of real estate obligations. The fire insurance companies contained a larger proportion of rails and utilities which were due to their larger holdings of common stocks in these fields. They also showed a much greater percentage invested in

TABLE XVIII

COMPARATIVE DISTRIBUTION OF INVESTMENTS OF TRUST INSTITUTIONS AND FIRE INSURANCE COMPANIES BY FIELDS, 1932

Field of Investment	Trust Institutions	Fire Insurance Companies[a]
Government	17.7%	14.0%
Railroad	7.5	18.3
Utility	12.5	15.8
Industrial	29.3	17.0
Finance	4.1	18.9
Real Estate	27.3	3.8
Miscellaneous	1.6	12.2
Total	100.0	100.0

[a] Ten large fire insurance companies. *Best's Insurance Reports—Fire and Marine,* 1933.

United States government bonds and in bank and insurance company stocks.

COMPARISON OF INVESTMENTS OF TRUST INSTITUTIONS WITH THOSE OF OTHER INSTITUTIONS BY FIELDS.—The distribution of investments, according to fields, of trust institutions compared with New York Savings banks and Harvard University is exhibited in Table XIX.

TABLE XIX

DIVERSIFICATION OF INVESTMENTS BY FIELDS IN TRUST INSTITUTIONS, NEW YORK SAVINGS BANKS AND HARVARD UNIVERSITY, 1932

Field of Investment	Trust Institutions	New York Savings Banks[a]	Harvard University[b]
Government	17.7%	16.2%	11.0%
Railroad	7.5	12.6	17.0
Utility	12.5	3.3	28.0
Real Estate	27.3	60.4	13.0
Others[c]	35.0	7.5	31.0
Total	100.0	100.0	100.0

[a] *Report of the Superintendent of Banks,* 1932.
[b] Jordon, David F., *Investments,* (1933), pp. 266-7.
[c] Includes industrials, finance and miscellaneous.

It is interesting to note that both the savings banks and Harvard carried a larger proportion in rails, than did trust institutions. Utilities were more favored by Harvard. The savings banks primarily selected real estate instruments. Trust institutions contained a greater percentage of government obligations and industrial securities.

DIVISION OF BONDS, PREFERRED STOCK, AND COMMON STOCK ACCORDING TO FIELDS OF INVESTMENT—BONDS.—In Table VIII is set forth the division of bonds, preferred stocks, and common stocks of the composite assets among the various fields of investment. According to this Table, state and municipal obligations were the largest single item of the bond group,[10] constituting the largest percentage of the composite fund. It was the only bond item which at any time involved 10 per cent of the composite assets. In 1919 and 1920, however, railroad bonds exceeded state and municipal obligations. In the aggregate, government obligations held first place over rails, utilities, or industrials by an average of more than 50 per cent. Corporate bonds as a composite, however, exceeded government bonds by a small fraction.

The proportional distribution of bonds is exhibited in Table XX.

TABLE XX

DISTRIBUTION OF BONDS OF 196 TRUSTS ACCORDING TO FIELDS, IN THE INVENTORY, 1919 AND 1932

Field of Investment	Inventory	1919	1932
Government	40.3%	41.1%	51.6%
Railroad	38.6	39.7	14.8
Utility	16.4	12.2	25.1
Industrial	4.7	7.0	8.5
Total	100.0	100.0	100.0

These figures show the dominant position of governmentals, especially in 1932. Each group of bonds except rails showed an increase; rails shrank more than 60 per cent. The bond holdings were concentrated at the end in governmentals and utilities, the two groups constituting 76.7 per cent of the total. This is a sound policy for such a period and gives strength to a portfolio, as bonds alone comprised 34.3 per cent of the investments in 1932.

The comparative distribution, according to fields, of the bonds of the trust portfolios with those held by fifty-two life insurance companies is shown in Table XXI on page 178.

Bonds constituted 34 per cent of the investments of life insurance companies and 34.3 per cent of the trust institutions. The trust institutions had twice the proportion in governmentals as did the insurance companies. Rails were the principal item in the bond account of insurance companies, the proportion being

[10] No attempt has been made to give a separate classification to real estate bonds.

TABLE XXI

DISTRIBUTION OF BONDS ACCORDING TO FIELDS IN TRUST INSTITUTIONS AND LIFE INSURANCE COMPANIES, 1932

Field of Investment	Trust Institutions	Life Insurance Companies[a]
Government	51.6%	24.7%
Railroad	14.8	44.4
Utility	25.1	25.6
Industrial	8.5	5.3[b]
Total	100.0	100.0

[a] Fifty-two life insurance companies. *Supra,* Table XVII, n. a.
[b] Includes real estate bonds.

three times that held by the trust institutions. It would seem that the policy of trust institutions was more conservative with respect to bonds.

PREFERRED STOCKS.—In Table XXII is shown the apportionment of preferred stocks in trust institutions according to fields.

TABLE XXII

DISTRIBUTION OF PREFERRED STOCKS OF 196 TRUSTS ACCORDING TO FIELDS, IN THE INVENTORY, 1919 AND 1932

Field of Investment	Inventory	1919	1932
Railroad	22.1%	34.2%	16.0%
Utility	11.7	8.9	16.0
Industrial	66.2	56.9	68.0
Total	100.0	100.0	100.0

The distribution of preferred stocks according to fields in trust institutions and life insurance companies is exhibited in Table XXIII.

TABLE XXIII

DISTRIBUTION OF PREFERRED STOCKS ACCORDING TO FIELDS IN TRUST INSTITUTIONS AND LIFE INSURANCE COMPANIES, 1932

Field of Investment	Trust Institutions	Life Insurance Companies
Railroad	16.0%	18.2%
Utility	16.0	36.4
Industrial	68.0	45.4
Total	100.0	100.0

In the senior stock group industrials predominated throughout, constituting around two-thirds of the total for trust institutions in 1932. Many of these issues were substantial investments, securities of outstanding companies, preceded by little or no debt. Others involved a considerable degree of risk. In a number of cases their dividends were omitted or reduced. Pre-

ferred stock, however, played a minor part in the composite assets of the trusts.

COMMON STOCKS.—The apportionment of common stocks according to fields in trust institutions is set forth in Table XXIV.

TABLE XXIV

DISTRIBUTION OF COMMON STOCKS OF 196 TRUSTS BY FIELDS, IN THE INVENTORY, 1919 AND 1932

Field of Investment	Inventory	1919	1932
Railroad	26.8%	28.8%	5.2%
Utility	21.3	23.2	9.9
Industrial	36.3	35.4	72.2
Finance	15.6	12.6	12.7
Total	100.0	100.0	100.0

The figures show that industrials predominate in the common stock group. From 1923 to 1932 they constituted over 50 per cent of all common stocks, rising to 72.2 per cent in 1932. Over 18 per cent of the aggregate principal, an average for the fourteen years, was in industrial common stocks. The large holdings of these securities are attributed first to the receipts from the grantor, which amounted to 14 per cent of the total assets. Second, these instruments were purchased for a number of trusts, especially by the Boston and Cleveland trust institutions. The appreciation of many of these stocks was also a factor.

The proportion carried in railroad and utility common stocks was greatly reduced throughout the period. Bank and insurance stocks were more prominent at the end of the period than either rails or utilities.

The division of common stocks, according to fields, of trust institutions as compared with fire insurance companies and investment trusts is presented in Table XXV.

TABLE XXV

DISTRIBUTION OF COMMON STOCKS ACCORDING TO FIELDS IN TRUST INSTITUTIONS, FIRE INSURANCE COMPANIES, AND INVESTMENT TRUSTS, 1932

Field of Investment	Trust Institutions	Fire Insurance Companies[a]	Investment Trusts[b]
Railroad	5.2%	14.3%	4.2%
Utility	9.9	9.4	38.8
Industrial	72.2	28.5	41.1
Finance	12.7	47.8	15.9
Total	100.0	100.0	100.0

[a] Ten large fire insurance companies. *Best's Insurance Reports—Fire and Marine,* 1933.

[b] Six management investment trusts. *Keane's Manual of Investment Trusts,* 1933.

TABLE XXVI

RELATIVE DISTRIBUTION OF INVESTMENTS ACCORDING TO FIELDS IN TRUSTS GROUPED BY SIZES FOR EACH YEAR, 1919-1931

No. of Trusts	Size	Field of Investment	1919 %	1920 %	1921 %	1922 %	1923 %	1924 %	1925 %	1926 %	1927 %	1928 %	1929 %	1930 %	1931 %
		Government	8.0	10.4	11.4	10.3	11.2	7.1	4.8	5.0	5.1	4.1	4.3	4.6	4.8
		Railroad	22.6	21.8	21.5	20.0	18.8	18.8	18.7	17.8	14.0	14.0	13.4	12.8	12.2
	0	Utility	13.4	13.6	12.3	11.4	11.6	12.4	11.3	11.5	10.4	11.0	11.3	12.8	14.2
36	to	Industrial	19.5	19.4	22.0	26.7	26.6	26.2	25.2	25.7	25.5	26.2	26.3	25.1	24.4
	25,000	Real Estate	35.5	33.5	32.3	29.8	30.2	34.3	39.7	39.2	44.1	44.2	43.0	42.2	41.6
		Miscellaneous	1.0	1.3	0.5	1.8	1.6	1.2	0.3	0.8	0.9	0.5	1.7	2.5	2.8
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Government	14.7	16.5	15.1	16.0	13.7	12.5	11.2	10.7	8.5	5.7	5.8	5.4	5.8
		Railroad	12.6	11.7	11.9	10.6	11.0	11.8	12.1	12.3	12.2	14.2	13.2	13.3	13.2
	25,000	Utility	9.8	10.9	10.8	9.7	10.0	7.9	11.5	11.8	12.1	14.9	15.1	16.8	17.2
50	to	Industrial	17.4	17.9	19.5	18.9	18.1	18.3	16.6	15.9	14.7	16.0	15.9	17.3	17.8
	75,000	Real Estate	43.7	42.3	41.6	43.6	43.1	42.6	46.6	48.0	51.1	48.0	48.7	44.8	43.8
		Miscellaneous	1.8	0.7	1.1	1.2	4.1	6.9	2.0	1.3	1.4	1.2	1.3	2.4	2.2
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Government	14.8	17.5	18.8	15.3	14.9	14.2	11.1	10.7	9.1	7.5	7.6	5.2	5.0
		Railroad	16.0	15.6	15.4	15.9	15.0	15.2	14.8	13.9	13.1	11.7	12.3	13.0	12.7
	75,000	Utility	7.6	7.2	7.6	7.6	8.4	8.6	8.4	8.4	9.2	10.2	11.7	13.3	16.5
42	to	Industrial	17.8	17.2	17.0	17.4	17.6	18.2	18.3	18.1	16.8	15.2	18.4	19.5	17.7
	200,000	Real Estate	38.8	35.5	35.0	37.2	37.8	39.1	42.0	43.1	46.7	49.3	42.8	41.3	40.2

No. of Trusts	Size	Field of Investment	1919 %	1920 %	1921 %	1922 %	1923 %	1924 %	1925 %	1926 %	1927 %	1928 %	1929 %	1930 %	1931 %
		Miscellaneous	5.0	7.0	6.2	6.6	6.3	4.7	5.4	5.8	5.1	6.1	7.2	7.7	7.9
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Government	10.1	12.2	15.3	16.3	18.8	20.8	20.4	18.1	16.1	14.2	12.5	13.0	13.3
		Railroad	20.2	22.2	20.7	19.0	17.8	16.4	16.2	16.0	16.0	14.6	11.8	10.4	8.9
	200,000	Utility	14.2	13.3	13.7	12.9	13.8	14.1	13.2	13.6	12.1	13.0	16.2	18.3	21.6
42	to	Industrial	20.3	19.3	22.0	23.5	21.3	19.5	18.6	17.7	23.6	23.6	24.7	23.4	24.2
	500,000	Real Estate	27.3	25.1	20.9	20.0	21.0	22.3	25.3	27.5	26.8	30.6	30.5	28.0	26.8
		Miscellaneous	7.9	7.9	7.4	8.3	7.3	6.9	6.3	7.1	5.4	4.0	4.3	6.9	5.2
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Government	6.3	6.9	6.8	6.5	6.8	8.6	10.1	9.0	9.0	7.0	7.6	7.9	8.5
		Railroad	37.7	37.4	30.6	27.8	24.8	24.7	24.0	24.1	25.8	26.6	25.8	24.1	23.0
	500,000	Utility	6.9	7.0	6.8	7.2	7.5	9.2	10.1	11.0	11.8	14.4	15.8	16.6	17.9
10	to	Industrial	9.6	9.7	10.0	10.2	15.4	14.8	12.4	11.8	10.8	11.4	12.1	13.0	12.8
	1,000,000	Real Estate	35.4	35.5	41.7	41.2	37.4	36.0	36.2	36.0	31.1	29.6	28.0	27.5	26.8
		Miscellaneous	4.1	3.5	4.1	7.1	8.1	6.7	7.2	8.1	11.5	11.0	10.7	10.9	11.0
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		Government	10.1	10.8	16.1	16.8	16.3	16.0	14.9	14.2	13.8	14.5	17.8	18.3	18.7
		Railroad	21.2	20.8	18.6	17.6	16.5	16.5	16.4	16.0	14.3	11.4	9.0	8.1	8.1
	1,000,000	Utility	12.3	12.2	10.1	9.9	8.6	8.5	6.7	6.3	6.2	7.2	7.8	8.0	8.1
16	or	Industrial	17.9	18.0	21.8	24.4	28.8	29.1	29.0	28.8	30.0	32.1	35.2	35.0	34.7
	Over	Real Estate	33.0	32.8	28.1	24.2	22.4	23.3	27.8	29.8	30.4	28.8	27.1	26.5	26.4
		Miscellaneous	5.5	5.4	5.3	7.1	7.4	6.6	5.2	4.9	5.3	6.0	3.1	4.1	4.0
		Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

The Table shows wide differences in the policies of these various types of institutions. Industrial common stock predominated in the trust institutions and investment trusts, while finance stock was most prominent with the fire insurance companies. Industrials were the next most favored common stock with the fire insurance companies. Utility common stock came second with the investment trusts and constituted nearly as large a proportion as industrials. In general, industrial common stocks may be considered first choice among these institutions.

DISTRIBUTION OF TRUST INVESTMENTS BY FIELDS IN TRUSTS GROUPED ACCORDING TO SIZE.—Table XXVI on pages 180-181, shows, with respect to the fields of investment, the distribution of investments in trusts classified according to size.

From these data we note that government obligations decreased in the groups ranging under $500,000 in size, but were increased in the two upper groups. Rails had a slight gain in the group from $25,000 to $75,000, but decreased in all other classes. Utility obligations decreased in only one group, those of $1,000,000 or over. In the other classes ranging up to $1,000,000, the percentage allocated to the utility field was augmented. The trusts in the group of $1,000,000 and over showed a pronounced increase in the proportion of industrial securities. Likewise, the group below $25,000 had a gain in this type of investment. In the remaining classes of trusts, the trends were not certain, but in general, the last few years showed some increase in industrials. The proportion contained in real estate was increased in the groups ranging under $500,000 in size. This item was composed principally of real estate obligations in these classes. Real estate showed a shrinkage in the two largest classes of accounts—principally because of the sale of real property which had been received in relatively large proportions in these trusts. No major differences seem to appear among the various groups with respect to trends in the fields of investment, or to the proportions invested in the different fields.

Chapter XII

FURTHER DISTRIBUTION OF TRUST INVESTMENTS

TYPES OF INVESTMENT SELECTED BY CORPORATE FIDUCIARIES.—A phase of trust institution investing not revealed in the previous material is the number of accounts containing the various types of investment. The number of trusts carrying each security in the inventory was given in Table VII. Our next consideration is to note how many accounts contained each type of investment at the end[1] of the trusts and to compare the changes with the holdings at the beginning of the trusts. This information is summarized in Table XXVII on page 184. It exhibits those items which were widely favored by the trustee investors and the ones that were decreased as compared with the distribution presented by the grantor.

By the end of the period studied considerable change had been effected in the investments received from the donor. More accounts carried all types of bonds, railroad and utility preferred stocks, railroad common stocks, and real estate mortgages or bonds at the end than at the beginning, while fewer accounts carried investments of the other types discussed. Real estate obligations showed a most pronounced increase, appearing in eighty-eight trusts at the beginning and in one hundred sixty-eight at the end. Utility preferred stocks rose from forty-three to sixty-one, and railroad bonds increased from seventy-two to ninety-four. Real estate showed the largest decrease of any item listed; only thirty-one trusts carried it in the last year, while it was a part of the assets of fifty-four accounts when the property was received by the trust institutions. Bank stocks dropped from fifty-five to thirty-five, the second largest drop in any type of investment.

Excluding real estate obligations, bonds, as a class, showed a substantial increase in the number of trusts choosing them. Preferred stocks as a group were also increased but much less than bonds. Common stocks, however, appeared in thirty-four fewer accounts in the last year than in the inventory.

[1] End of trusts is used to signify the last year for which data were collected.

TABLE XXVII

FREQUENCY OF VARIOUS TYPES OF INVESTMENT IN 196 TRUSTS WITH THE INDICATED PER CENT OF THE TOTAL INVESTMENT IN EACH TYPE IN THE INVENTORY AND AT THE END OF THE TRUSTS

Type of Investment	Number of Trusts Carrying Each Type of Invest.		Number of Trusts with Indicated Per Cent of Total Investment in Specified Type of Security											
			0-5%		5-10%		10-25%		25-50%		50-75%		75-100%	
	Beginning	End	Beginning	End	Beginning	End	Beginning	End	Beginning	End	Beginning	End	Beginning	End
U. S. Government Bonds	59	73	33	53	9	12	8	7	4	1	3	0	2	0
State & Municipal Bonds	44	61	18	29	6	12	11	11	6	6	2	2	1	1
Railroad Bonds	72	94	26	25	12	16	18	38	8	9	6	5	2	1
Utility Bonds	52	88	22	16	13	20	11	36	5	15	1	1	0	0
Industrial Bonds	47	62	31	26	9	22	5	13	1	1	0	0	1	0
Railroad Preferred	45	50	22	30	12	14	8	6	3	0	0	0	0	0
Utility Preferred	43	61	23	21	6	18	8	18	4	4	1	0	1	0
Industrial Preferred	83	77	33	37	17	16	17	19	10	3	4	1	2	1
Railroad Common	58	61	13	23	15	16	16	18	10	4	4	0	0	0
Utility Common	64	59	17	26	14	13	18	17	8	3	5	0	2	0
Industrial Common	88	76	15	23	13	12	21	21	17	16	14	2	8	2
Bank Stocks	55	35	22	14	12	8	15	9	5	3	0	1	1	0
Real Estate Obligations	90	168	24	21	14	25	19	36	12	29	8	28	13	29
Real Estate	54	31	11	6	8	5	8	8	9	4	10	3	8	5

In the fields of investment real estate obligations were listed in seventy-eight more accounts in the last year than in the beginning. Real estate proper, however, was dropped from twenty-three trusts, so the real estate field showed an increase of only fifty-five. The utility field made a pronounced gain, being held by forty-nine more trusts at the end than in the inventory. Rails were selected by thirty additional accounts but industrials were contained in three less trusts at the end than in the inventory.

In the end year real estate obligations occurred most frequently, being listed in 168 accounts, thus showing that this type of investment was overwhelmingly favored by the trust institutions. Railroad bonds rated second, being held in nearly one-half of the trusts. Next in order of frequency were utility bonds, industrial preferred stocks, industrial common stocks and United States government bonds. Real estate, bank stocks, and railroad preferred stocks were found less frequently than other types of investment.

These figures show a wider diversification with respect to the types of investment held, at the end period than in the inventory.

The policy followed with respect to choosing various types of investment differed somewhat from state to state. For instance, the trust institutions in Boston registered the largest increase in the number of trusts selecting each kind of corporate bond, but in the other states there was a decrease in the number of accounts investing in corporate bonds.

In New York, there were fewer trusts handling each type of preferred stock at the end than in the beginning, but in Boston, there was an increase in the number handling these securities. There seemed to be no set policy in other states of either decreasing or increasing the number of accounts holding preferred stocks, some decreasing one issue, and increasing others. In four states there was a decrease in the number of trusts listing each type of common stock, with the exception of railroad common stock which remained the same in Cleveland and St. Louis. In Massachusetts, however, a decrease occurred only in the number of accounts choosing bank stocks, while an appreciable increase occurred in the number of trusts containing all other types of common stocks.

Real estate obligations were contained in a substantially larger number of accounts in all states at the end, as compared with the inventory, while the reverse was true with respect to real estate proper. State and municipal bonds were also increased in all five cities, and United States government bonds in all

except Cleveland, where the number of trusts listing these securities was unchanged.

PROPORTION OF TRUST PRINCIPAL CONTAINED IN THE DIFFERENT TYPES OF INVESTMENT.—The second part of Table XXVII shows the number of trusts containing the different kinds of investments in stated per cents. A perusal of these data enables us to see that United States government bonds constituted only a small proportion of the total holdings of the trusts in which such bonds were held. In fact, almost three-fourths of such accounts had less than 5 per cent of their assets in these bonds at the end. In the inventory forty-two out of fifty-nine trusts had less than 10 per cent so invested, while sixty-five out of seventy-three accounts contained this proportion at the end. State and municipal bonds were more prominent. Approximately three-fourths of the trusts containing these bonds in the last year had less than 25 per cent so invested, nearly one-half having 5 per cent or less.

Railroad and utility bonds were carried in somewhat larger proportions than were government bonds. Over 50 per cent of the trusts selecting railroad bonds invested from 10 to 50 per cent in them. About 16 per cent of the ninety-four accounts carrying railroad bonds showed 25 per cent or more allocated to this type of security. Forty-one of the ninety-four, or 43 per cent, had less than 10 per cent so invested. Utility bonds were listed in fewer accounts than were rails but they constituted 25 per cent or more of nearly one-fifth of the trusts investing in this type of security. These bonds comprised 10 to 50 per cent of fifty-one accounts, or 58 per cent of those investing in utility bonds. Thus, there was a decided trend to carry utility bonds not only in a greater number of accounts at the end than at the beginning but also a tendency among the respective trusts to carry a larger per cent in these bonds. Industrial bonds made up less than 10 per cent of over three-fourths of the trusts which held this type of security at the end. Only one account contained over 25 per cent in industrial bonds.

For the most part preferred stocks constituted a small percentage of the accounts containing this type of investment, only a very small per cent carrying as much as 25 per cent in the end period. There was a decided trend to decrease the proportions invested in railroad and industrial preferred stocks. A trend to select larger proportions of utility preferred stocks was evident in an increasing number of trusts. As a group the proportion allocated to preferred stocks decreased among the individual trusts.

The number of trusts choosing common stocks for investment showed a decrease of thirty-four in the end as compared with the inventory. The tendency was also for the trusts to invest a smaller percentage in common stocks. For instance, thirty-three trusts held 50 per cent or more in common stocks at the beginning while in the last year of accounting only five contained this proportion. There was also a decrease from forty to twenty-six accounts investing from 25 to 50 per cent in common stocks.

Real estate obligations showed the most pronounced gains both in the number of trusts choosing them, and in the proportions they constituted of the various trusts. In the inventory, less than 25 per cent of the accounts containing real estate obligations held 50 per cent or more in this item; at the end, fifty-seven out of one hundred sixty-eight, or 33.3 per cent, held this proportion. There was a relative decrease in the number of trusts investing less than 25 per cent in real estate mortgages or bonds, and an increase in the number investing over 25 per cent. Real estate proper, likewise, was often a large proportion of the investment in those accounts in which it was held. In the inventory, eighteen trusts contained 50 per cent or more of this type of investment, at the end eight showed a like proportion.

It is interesting to note that there was a larger number of accounts investing 75 per cent or over in one item at the end than in the inventory. This change was due to the increasing prominence of real estate obligations. In the beginning they comprised 75 per cent or more of thirteen of the forty-one trusts containing this proportion in any one type of investment and at the end they constituted a like amount in twenty-nine out of thirty-nine trusts. There was a decrease from fifty-eight to forty-three accounts containing from 50 to 75 per cent in any one type of investment. Approximately the same number invested from 25 to 50 per cent in a single item for each period—inventory and end.

There was a decided trend for the trusts investing in real estate obligations to allocate a larger percentage of their assets to this item, but this tendency was greater in New York than in any of the other states. A majority of the trusts in each state slightly decreased the proportion allocated to United States government bonds. The Boston and St. Louis trusts decreased the percentage invested in state and municipal bonds, but in the three other cities the accounts enlarged the amount in these securities. Real estate proper was decreased in all the trusts in which it was held.

The procedure regarding corporate bonds, however, differed

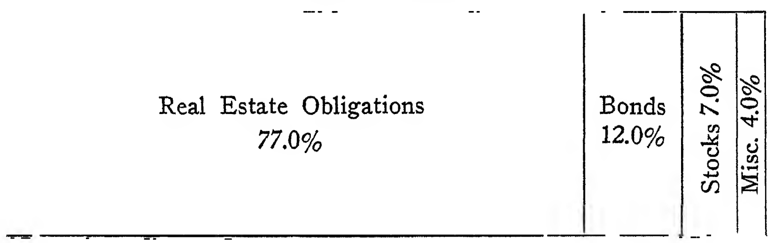
in the several states. There was a pronounced increase in the number of Boston trusts holding from 5 to 50 per cent in corporate bonds. In New York, the number of accounts selecting railroad bonds increased in all brackets up to 75 per cent, but decreased throughout with respect to industrial bonds. The number of trusts selecting utility bonds increased, especially in the lower brackets. There was an increase in the number of Chicago trusts which chose utility bonds in proportions from 5 to 50 per cent as well as in those choosing railroad and industrial bonds of 10 per cent or less. Cleveland decreased to a small degree the proportion contained in corporate bonds throughout.

Regarding proportions allocated to preferred stocks, New

CHART VI

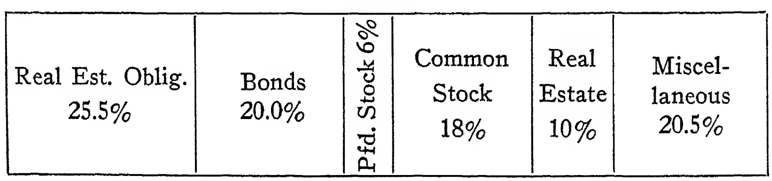
AVERAGE DIVERSIFICATION OF INVESTMENTS IN FIFTY-SEVEN TRUSTS CONAINING OVER 50 PER CENT IN REAL ESTATE OBLIGATIONS

END OF TRUSTS



Real estate oblig.	77.0%	Preferred stock	3.0%
U. S. bonds	0.5	Common stock	4.0
State & Mun. bonds	1.5	Real estate	2.6
Railroad bonds	5.0	Miscellaneous	1.4
Other bonds	5.0		

INVENTORY



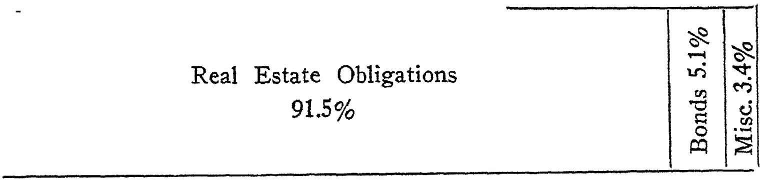
Real estate oblig.	25.5%	Preferred stock	6.0%
U. S. bonds	5.0	Ind. com. stock	7.5
State & Mun. bonds	5.0	Other com. stock	10.5
Railroad bonds	5.5	Real estate	10.0
Other bonds	4.5	Miscellaneous (principally cash)	20.5

York showed a decrease for all types in each bracket, except that more trusts held 5 per cent or less in railroad preferred stocks at the end than at the beginning. In Chicago, the number of accounts investing from 5 to 50 per cent in utility preferred stocks increased, but there was a drop in the number carrying other issues in this group. A small increase occurred in the number of trusts in Boston carrying up to 25 per cent in preferred stocks; no account contained more than this percentage at the end. In Cleveland, the number investing from 10 to 25 per cent in preferred stocks rose, but decreased in all other proportions. St. Louis trusts decreased the proportion contained in this type of investment.

CHART VII

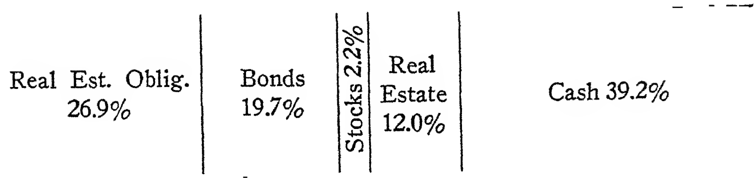
AVERAGE DIVERSIFICATION OF INVESTMENTS IN TWENTY NEW YORK TRUSTS CONTAINING OVER 75 PER CENT IN REAL ESTATE OBLIGATIONS

END OF TRUSTS



Real estate oblig.	91.5%	Preferred stock	0.2%
U. S. bonds	1.2	Common stock	0.2
State & Mun. bonds	2.1	Real estate	1.8
Railroad bonds	1.8	Miscellaneous	1.2

INVENTORY



Real estate oblig.	26.9%	Preferred stock	1.0%
U. S. bonds	5.7	Common stock	1.2
State & Mun. bonds	6.9	Real estate	12.0
Railroad bonds	6.4	Cash	39.2
Other bonds	0.7		

There was a definite increase in the number of Boston trusts investing up to 25 per cent in common stocks—excluding bank stocks—but a decrease in the number containing 50 per cent or over. In general all other states decreased the number of trusts carrying each of the specified proportions in these issues. In each state the trusts decreased the proportion allocated to bank stocks.

TRUSTS CONTAINING A LARGE PROPORTION IN REAL ESTATE OBLIGATIONS.—There were fifty-seven trusts containing 50 per cent or more in real estate obligations in the last year of accounting. Thirty-three of these trusts came from New York, nine from Chicago, eight from Cleveland, five from St. Louis and two from Boston. A comparison of the average diversification of investments in these accounts for the last year with their inventory is shown in Chart VI on page 188.

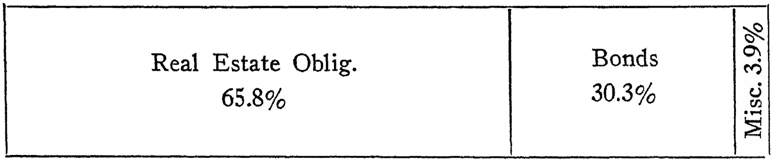
Twenty New York trusts contained in their last year of accounting 75 per cent or more of real estate mortgages or bonds. They ranged in size from less than $25,000 to approximately $500,000. The average way in which the aggregate funds of these accounts were invested in the last year of their operation as compared with their inventory is presented in Chart VII on page 189.

TRUSTS CONTAINING ONLY CASH IN THE INVENTORY.—Eight trusts in New York began with 100 per cent in cash. They varied in size from about $15,000 to $1,000,000. Chart VIII shows how these funds were invested in the last year of accounting.

CHART VIII

AVERAGE DIVERSIFICATION OF INVESTMENTS IN EIGHT NEW YORK TRUSTS CONTAINING ONLY CASH IN THE INVENTORY

END OF TRUSTS



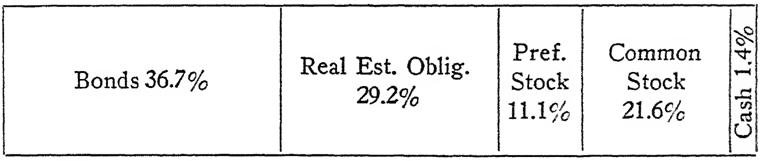
Real estate oblig.	65.8%	U. S. bonds	1.4%
State & Mun. bonds	24.6	Miscellaneous	3.9
Railroad bonds	4.3		

In Boston there were nine trusts containing only cash when the property was received by the trust institutions. The investments of these trusts as a composite are graphically represented in Chart IX.

CHART IX

AVERAGE DIVERSIFICATION OF INVESTMENT IN NINE BOSTON TRUSTS CONTAINING ONLY CASH IN THE INVENTORY

END OF TRUSTS



Government bonds:		Preferred stocks:	
U. S.	0.3%	Railroad	3.4%
State & Mun.	2.5	Utility	6.5
Foreign	0.7	Industrial	1.2
Corporate bonds:		Common stocks:	
Railroad	9.7	Railroad	9.6
Utility	18.0	Utility	7.2
Industrial	5.5	Industrial	4.8
Real estate oblig.	29.2	Cash	1.4

NUMBER OF INVESTMENT ITEMS CONTAINED IN THE TRUST PORTFOLIOS.—The investment of funds carries with it the assumption of some risk. One way to minimize this risk is to distribute the fund over an area sufficiently wide to reduce the effect of any single loss. To what extent trust institutions distributed trust investments over individual securities may be seen from the number of separate investment items carried in trust portfolios. These data based on the list of securities shown in the last year of accounting of the trusts for each city and for the composite of 196 trusts are given in Table XXVIII.

TABLE XXVIII

NUMBER OF INVESTMENT ITEMS CONTAINED IN TRUST PORTFOLIOS[a]

City	Number of Trusts	Average Number of Items
New York	80	23
Boston	41	36
Chicago	23	33
Cleveland	34	18
St. Louis	18	20
Composite	196	26

[a] Last year for which data were collected.

The average number of items in all the trusts under $75,000 was sixteen, for the trusts under $25,000, it was thirteen.

There was a wide variation in the number of separate items

contained in the various trusts. The New York trusts showed a range from four items in a $40,000 account to ninety-eight in a $1,000,000 trust. In Boston they varied from twelve in a $20,000 account to one hundred and two in one of $600,000. The number of items in the Chicago trusts jumped from eleven in a $17,000 trust to one hundred thirteen in a $3,000,000 account. A $50,000 trust in Cleveland contained only one item—real estate —while a $2,600,000 trust held eighty-five separate investments. St. Louis trusts ranged from four items in a $19,000 account to seventy-four in a $125,000 trust.

Although, on the average, the larger trusts held a greater number of different investments, there were many exceptions among individual accounts. For example, a $3,500,000 trust contained only seventeen items while a $55,000 account held twenty-six different investments. Many similar examples could be given.

UNIT OF INVESTMENT.—There was no definite policy noted regarding an investment unit in the trusts in any of the cities. While many accounts did contain definite units of investment in sums of $5,000 or $10,000 or multiples thereof for each investment, they were quite in the minority. An examination of specific trusts will show the variety of units contained in representative accounts. A $900,000 trust containing seventy-four items had investment units ranging from $3,000 to $33,000. A trust with fifty-five different investments, amounting to $3,200,000, had units ranging from $200 to $1,600,000. In a $120,000 account of twenty-nine items, the smallest was $1,000 and the largest $8,000. A $40,000 account containing eighteen items had units of investment ranging from $1,000 to $3,000. In a $62,000 trust the units varied from $100 to $6,000.

DISTRIBUTION OF BONDS ACCORDING TO MATURITIES. Bonds mature at definite periods of time, but their lives vary considerably according to the conditions at the time of issue, such as the credit market, type of security behind the bonds, prejudice of investors, etc. The timeliness of maturities is often a matter of much importance to the investor, who may need a constant flow of cash or may desire ready cash to take advantage of good investment opportunities. For example, the liquidity factor is an important aspect of the management of a bank's bond account. It means that cash assets can be replenished if necessary, and withdrawals met without sacrifice. The proper maturities in the bonds selected serve to make the investment account liquid. Thus, a liberal proportion of the investment account should be short-term securities, because long-term bonds, as a rule, do not carry the same degree of assurance that they can be sold at all

times without a loss. In the investment of trust assets, however, the liquidity factor is not so important. Accordingly, trust institutions may select maturities more in accordance with economic and business conditions.

The study of maturities of bonds in trust portfolios of trust institutions under investigation was predicated upon an analysis of the investments in the last year of accounting for which data were available. The composite of trust investments shows the following distribution of bonds according to maturities: one to four years, 15.6 per cent; five to fourteen years, 35.7 per cent; fifteen to forty years, 38.4 per cent; forty-one years or over, 10.3 per cent.

Although the majority of these bonds were listed in the portfolios of various accounts during 1931 and 1932, most of them had been chosen prior to that time. Thus it is difficult to say that the distribution reflects any definite opinion regarding the trends of business or of interest rates. Many of these issues were selected before there was any clear notion that a downward trend would take place in these factors.

A comparison of the holdings of trust institutions with those of thirty leading colleges and universities and an outstanding foundation brings out some interesting facts.[2] The comparative distribution of maturities by these institutions is set forth in Table XXIX.

TABLE XXIX

COMPARATIVE DISTRIBUTION OF BOND MATURITIES[a] OF TRUST INSTITUTIONS, UNIVERSITIES AND A FOUNDATION

Time Until Maturity	Trust Institutions[b]	Universities	Foundation
Less than 5 years.............	15.6%	12.9%	1.0%
5 to 14 years.................	35.7	37.9	27.0
15 years or more..............	48.7	48.7	72.0
Total	100.0	100.0[c]	100.0

[a] Universities and foundation portfolios in 1931.
[b] Last year for which data were collected.
[c] 0.5% doubtful.

From the foregoing Table there appears to be a similarity of policy between the trust institutions and the universities and colleges. The foundation, however, followed a somewhat different policy, placing a very large proportion, 72 per cent of its holdings, in relatively long-term bonds. On such a showing, it

[2] Data on American universities and colleges and a foundation taken from Wood, Struthers & Company, *Trusteeship of American Endowments,* (1932), p. 76.

might be concluded that the foundation projected its forecast into the future, especially with respect to interest rates. Trust institutions and universities and colleges also carried a substantial portion of comparatively long-term maturities, about 48.7 per cent; this might indicate that those concerned believe that interest rates will tend downward for some years.

The distribution of bond maturities among the five different cities is set forth in Table XXX.

TABLE XXX

DISTRIBUTION OF BOND MATURITIES OF TRUSTS IN FIVE CITIES[a]

Time Until Maturity	New York	Boston	Chicago	Cleveland	St. Louis	Total of 5 cities
Less than 5 years	10.3%	9.5%	20.7%	21.4%	23.5%	15.6%
5 to 14 years	26.7	45.1	35.5	43.0	23.5	35.7
15 to 40 years	39.9	40.1	38.3	33.4	34.7	38.4
41 years or more	23.1	5.3	5.5	2.2	18.3	10.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

[a] Last year for which data were collected.

These figures indicate there is little uniformity of practice among the trust institutions of the different cities. New York has nearly two-thirds of its bonds maturing fifteen years distant or longer; a little more than one-third matured in less than fifteen years. Cleveland, on the other hand, had only 35.6 per cent of its bonds maturing after the fourteenth year. Boston is unique in having 85.2 per cent of its bonds maturing within five to forty years. New York and St. Louis had the largest percentage maturing in the long-term period of forty-one years or longer. St. Louis had the highest proportion coming due in one to four years, and Boston the smallest. New York also had a small percentage falling within the period, one to four years.

Distribution of real estate obligations according to maturities followed an entirely different course from that of bonds. A majority of all of these investment items mature in less than five years.

A number of issues of doubtful maturity were likewise found in the trusts, but were not included in this study. Most of the items maturing in five years or longer were for less than fifteen years, the majority being under ten years. While a large per cent of the mortgages were of the short-term variety, many of them were extended or renewed one or more times, becoming in this way a medium or long-term investment. However, the percentage of such issues, the maturities of which have been advanced is not known.

Chapter XIII

THE QUALITY OF INVESTMENTS IN TRUST PORTFOLIOS

MEANING OF QUALITY. It is essential that the quality of investments in a trust portfolio be sound. By quality is meant the credit risk which a security entails. It is concerned with the analysis of investments from the standpoint of safety alone; no implication is made that investments rated as to quality are suitable to serve every investment purpose. The quality rating is predicated upon the risk that the maker of a bond, mortgage, or note cannot pay according to the terms stipulated in his contract, that the company whose stock is being held will not continue to be successful, profitable, and solvent. It is an appraisal of the risk of non-payment, of non-performance, of failure, of bankruptcy, of commercial death.

JUSTIFICATION FOR RATING INVESTMENTS.—Any grading of securities is only an approximation of their merit, even though it may have been performed with a great deal of care. The limitations of any system developed to appraise securities are obvious. Grading must be employed, however, and it has a definite value in the investment field. The justification for some system of grading investments rests upon the fact that without the distinctions thus resulting it would be practically impossible to have perspective upon any investment list. Such an analysis permits of useful conclusions and comparisons.

METHOD USED IN GRADING TRUST INVESTMENTS.—Since the degree of safety or quality is the most important characteristic of an investment it is highly significant to study this aspect of the investments made by the trust institutions. Each corporate item in each trust portfolio was graded according to the rating given in *The Fitch Bond Record* or *The Fitch Stock Record*. The investments graded were those contained in the portfolios during the last year for which data were available. The ratings for the composite assets were not for a single year, but covered a period from 1930 to 1932.[1] The ratings were for eighty-nine trusts in

[1] Data were not available for all the trusts for 1931 and 1932. Therefore, ratings could not be taken for the investments in all the trusts for the same year.

1930-1931, and for one hundred and seven in 1932. In all the trusts as an aggregate there were approximately 5,000 separate items. Since real estate, real estate obligations, foreign bonds, and bank stocks were not rated, and since there were many duplicate securities in different trusts, only several thousand different investment items were rated for all the trusts. State and municipal bonds were not rated by *Fitch;* the grading of these securities was obtained from other sources.

INVESTMENT QUALITY OF BONDS IN THE COMPOSITE ASSETS.—The distribution of bonds in the composite assets according to grades for the end period of the trusts, as designated above, is given in Table XXXI.

TABLE XXXI

DISTRIBUTION OF BONDS IN 196 TRUSTS ACCORDING TO QUALITY[a]

Rating	Per Cent of Total (dollar value)
AAA	35.8
AA	21.8
A	19.0
BBB	13.5
BB	3.0
Lower	1.7
Ungraded	5.2
Total	100.0

[a] For the end of the trusts.

A bond group averaging 76.6 per cent in grade A or above during this period must be regarded as fairly conservative. It is true that the grades average only moderately high because most of them were taken when the bond market was seriously affected by the depression, which had a devastating effect upon corporate and governmental securities, except Federal bonds. The enormous debts contracted by corporations and governments grew increasingly menacing as business declined, as values shrank, and as incomes almost dried up. Bonds previously entitled to a substantial rating on the basis of normal credit risk became of questionable value because of the impairment of earnings or because refinancing of maturing obligations could not be carried out without great difficulty. Recognition of these facts, however, should serve to call attention to the relatively high quality of the composite trust investments, especially the bonds.

No attempt was made to grade the bonds in the trusts classified according to size, as there were no significant distinctions

in the different sized trusts. In the accounts of an individual institution the portfolio of a $10,000 trust contained the same issues as those found in the large accounts.

Likewise no attempt was made to show the grades of securities for each individual trust institution or by states, as it was felt that this would needlessly complicate an already detailed study.

INVESTMENT QUALITY OF BONDS BY FIELDS.—The division of the composite bond fund between various fields of investment on a volume percentage as of the end period is as follows:

Field	Per Cent of Total[a] Bonds (dollar value)
Government	9.9
State and Municipal	41.4
Railroad	15.1
Utility	25.4
Industrial	8.2
Total	100.0

[a] Does not include land bank, foreign, or real estate bonds.

The foregoing indicates that trust institutions have a marked preference for state and municipal bonds and utility bonds. Railroad bonds were also quite important. There seemed to be an aversion, however, to industrial bonds. This aversion was even more marked regarding foreign bonds and land bank bonds.[2]

The volume percentage of the composite bond fund in the portfolios of American colleges and universities showed a much larger proportion in utilities, railroads, and industrials but a much smaller proportion in state and municipal issues as of 1931.[3]

The investment quality of bonds in the composite account, distributed according to fields, is presented in Table XXXII on page 198.

The average quality of railroad bonds, 76.7 per cent being grade A or better, has dropped under that of the public utilities, which have 85.8 per cent grade A or higher. The bondholdings in both of these fields are materially better than the industrials which rate only 56.3 per cent in this quality area. The grades for utility bonds are a reflection of the sound earning position maintained by public utility operating companies. A vast majority of the utility bonds represented operating companies, not holding companies. Their standing indicates that high grade

[2] Shown in Chapters X-XII.

[3] Wood, Struthers & Co., *Trusteeship of American Endowments,* (1932), p. 96.

TABLE XXXII

COMPARATIVE INVESTMENT QUALITY OF BONDS IN 196 TRUSTS ACCORDING TO FIELDS[a]

Rating	United States Government	State & Municipal	Railroad	Utility	Industrial
AAA	100.0%	40.1%	24.2%	40.4%	18.5%
AA	0.0	21.8	20.7	27.1	17.8
A	0.0	16.5	31.8	18.3	20.0
BBB	0.0	12.3	15.3	8.2	18.4
BB	0.0	3.2	3.9	1.9	3.4
Lower	0.0	1.9	2.0	0.6	1.6
Ungraded	0.0	4.2	2.1	3.5	20.3
Total	100.0	100.0	100.0	100.0	100.0

[a] For the end of the trusts.

public utility bonds had been chosen by the trust institutions. It is felt that the railroad bonds made a substantial showing considering the plight of this industry as a whole. It should be recognized that a substantial proportion of the railroad bonds held by the trust institutions are of the sound underlying type, high grade legals, the intrinsic merit of which will be maintained if the railroad industry is not bankrupt in the present crisis.

The industrial bonds show a fair proportion, 56.3 per cent, of A grade or better. On the other hand, a high percentage falls within the ungraded class; this indicates that many of the issues were local in nature and comparatively unknown. Then too, many of the bonds represented enterprises which had been drastically affected by the untoward circumstances prevailing since the autumn of 1929. It is doubtful, however, if industrial bonds were given the consideration in the average portfolio that was enjoyed by railroad or public utility bonds. Most of the industrials had been received from testators while the rails and utilities were largely selected by the trust institutions. Undoubtedly, too, the large percentage of ungraded bonds in this class is indicative of the lack of available and reliable information in the industrial field. Sixty-one per cent of the New York industrial bonds were unrated.

The small proportion of ungraded issues among the railroad and public utility bonds indicates that information in these two fields is more readily available and more nearly complete.

New York trusts contributed 61 per cent of the railroad bonds and 40.1 per cent of the government bonds. Chicago accounted for about 50 per cent of the state and municipal bonds and Boston for over 50 per cent of the public utility bonds and for slightly over 40 per cent of the industrial bonds.

INVESTMENT QUALITY OF PREFERRED STOCKS.—The total of preferred stocks is apportioned among the several grades as indicated in Table XXXIII.

TABLE XXXIII

DISTRIBUTION OF PREFERRED STOCKS IN 196 TRUSTS ACCORDING TO QUALITY[a]

Rating	Per Cent of Total (dollar value)
AAA	4.3
AA	14.2
A	15.0
BBB	37.9
BB	11.4
Lower	5.1
Ungraded	12.1
Total	100.0

[a] For the end of the trusts.

The investment quality of preferred stocks is distinctly less satisfactory than that of bonds. Only 33.5 per cent of preferred stocks in the composite fund were grade A or higher, while 76.6 per cent of the bonds were of this quality. Thus the senior stock issues are of questionable value for trust portfolios, as 66.5 per cent of them were below grade A, or unrated. Cleveland contributed nearly 50 per cent of the volume of preferred stocks.

INVESTMENT QUALITY OF PREFERRED STOCKS BY FIELDS.—The division of the preferred stocks of the composite fund shows the following volume percentages as of the end period.

Field	Per Cent of Total[a] Preferred Stocks (dollar value)
Railroad	16.0%
Utility	16.0
Industrial	68.0
Total	100.0

[a] End of trusts.

It is apparent that the trust institutions had a marked preference for industrial preferred stocks but a decided leaning away from rails and utilities. Undoubtedly the percentage distribution between these fields was influenced to some extent by the contents of the trusts as they were received by the trust institutions. However, Cleveland and Boston played the dominant role as investors in preferred stocks and the institutions in both of these cities purchased considerable sums of this type of investment. Thus the trust institutions should be given part credit for allocating the senior stocks to the different fields.

Fifty-two life insurance companies also favored industrial preferred stocks in 1932 but not to the same extent as did the trust institutions.[4] The insurance companies held a much larger proportion in utility preferred stocks. As of 1931 thirty American colleges and universities had a smaller proportion of their preferred stocks in industrials and a larger proportion in utilities and rails.[5]

The quality of preferred stocks related to distribution by fields is presented in Table XXXIV.

TABLE XXXIV

DISTRIBUTION OF PREFERRED STOCKS IN 196 TRUSTS ACCORDING TO GRADE BY FIELDS[a]

Rating	Railroad	Utility	Industrial
AAA	5.5%	6.0%	3.4%
AA	11.3	20.7	10.4
A	10.1	23.6	14.8
BBB	30.3	19.4	44.5
BB	19.2	9.8	11.7
Lower	10.7	5.4	4.2
Unrated	12.9	15.1	11.0
Total	100.0	100.0	100.0

[a] For the last year of the trusts.

The data clearly indicate that the investment in senior stocks made the poorest showing in the industrial group. This field must be rated weak and very unsatisfactory, the composite data for the five states showing only 28.6 per cent of this type of holdings rated A or better. The Cleveland trust institutions accounted for about two-thirds of the industrials and had a high per cent below grade A. Although the rails comprised 16 per cent of the aggregate preferred stocks they were showing the effects of the depression, as only 26.9 per cent were rated A or better. The utility group was distinctly the best group of preferred stocks, 50.3 per cent being rated A or higher. The preferred stock group had a rather large per cent of ungraded issues, a condition attributable to the many small local enterprises represented.

INVESTMENT QUALITY OF COMMON STOCKS.—It is the common belief that institutional investors do not hold common stocks in important amounts. As has been shown in this study, however, this is not true of trust institutions. Since the commitment in this class of investment was of major importance the investment

[4] See Table IX.

[5] Wood, Struthers & Company, *op. cit.*, p. 105.

worth of these stocks is highly significant. The quality of common stocks in the aggregate of investments, is exhibited in Table XXXV.

TABLE XXXV

DISTRIBUTION OF COMMON STOCKS IN 196 TRUSTS ACCORDING TO QUALITY[a]

Rating	Per Cent of Total[b] (dollar value)
AAA	1.1%
AA	3.2
A	6.7
BBB	20.8
BB	18.9
Lower	35.2
Ungraded	14.1
Total	100.0

[a] For the last year of the trusts.
[b] Does not include bank and finance stocks.

Common stocks were well divided among the different cities; consequently the ratings were representative of the last years for which data were collected, the major proportion being for 1931 and 1932. Even so, a grade of A or better for only 11.0 per cent of the common stocks is not adequate when we realize the significance of this class of investment in the composite assets. The low average quality of common stocks as an aggregate is explained by the fact that a large percentage of the issues came from the testators, and that insufficient changes had been made in this part of the portfolios. It should be noted, however, that in many trusts if the common stocks were once sold the trustee was forbidden to select other common stocks. Further, the legal factor in the case was frequently uncertain and therefore doubt arose regarding such changes. Many issues represented small local enterprises or businesses comparatively unknown in which frequently the testator or his family was interested.

INVESTMENT QUALITY OF COMMON STOCKS BY FIELDS.—The volume distribution of common stocks of the composite assets according to the fields of investment for the end period is set forth as follows:

Field	Per Cent of Total[a] Common Stocks (dollar value)
Railroad	6.1%
Utility	11.3
Industrial	82.6
Total	100.0

[a] Does not include bank and finance stocks.

The Table shows a distinct preference for only one type of security, industrial common stocks. That utility common stocks should be least favored is strange in the light of present facts. Undoubtedly the choice was made before it was realized that utilities would be in such a commanding position.

In contrast, American colleges and universities in 1931 held 13.7 per cent of their common stock fund in rails, 19.3 per cent in utilities, 48.9 per cent in industrials, and 18.1 per cent in bank and insurance.[6]

The investment quality of common stocks of the composite assets related to distribution by field is presented in Table XXXVI.

TABLE XXXVI

DISTRIBUTION OF COMMON STOCKS IN 196 TRUSTS ACCORDING TO QUALITY BY FIELDS[a]

Rating	Railroad	Utility	Industrial
AAA	0.0%	2.1%	0.2%
AA	0.2	6.4	1.2
A	0.8	16.8	5.2
BBB	8.3	30.3	16.4
BB	18.9	20.7	16.1
Lower	66.5	17.6	43.0
Unrated	5.3	6.1	17.9
Total	100.0	100.0	100.0

[a] For the end of the trusts.

Although bank and insurance stocks (practically all bank) were not graded they were substantial investments for the most part. The number of banks represented in the portfolios was quite small, being limited to a few of the strongest institutions in the cities represented in this study. An exception must be noted for Cleveland where two of the largest banks still remain closed. Also, a few of the less well-known banks of these cities or those in smaller cities whose shares were included detract somewhat from the list.

Relatively the utility shares were the superior group of common stocks. In this group 25.3 per cent qualified for high rating, A or better, while 30.3 per cent rated BBB. For the most part trust institutions had selected high grade stocks from the utility operating companies. The data also show that utility companies had not been subject to the ravages of the depression to the same degree as rails or industrials.

The ratings of railroad common stocks were very poor and serve to indicate the desperate condition of the railroads which

[6] Wood, Struthers & Company, *op. cit.*, p. 110.

during the past few years have been confronted with serious financial problems and a dearth of earnings.

Although industrials constituted 82.6 per cent of the aggregate, they were, in general, of very poor quality. Only 6.6 per cent were rated A or higher, quite an unfavorable showing as compared with the utility group. It should be explained that a high per cent of the industrial common stocks which rated very low came from Chicago and were contained primarily in one large account. The stock came from the testator, was retained by the trust institution, and had shown good results. It had appreciated considerably prior to the collapse in the stock market. About 45 per cent of the unrated common stocks came from Cleveland.

QUALITY OF INVESTMENT OF THE AGGREGATE OF STOCKS AND BONDS.—The investment quality of the aggregate of stocks and bonds is exhibited in Table XXXVII.

TABLE XXXVII

INVESTMENT QUALITY OF BONDS, PREFERRED AND COMMON STOCKS FOR LAST YEAR OF 196 TRUSTS

	AAA	AA	A	BBB	BB	Lower	Unrated
All Securities	17.4%	14.0%	12.1%	18.1%	10.8%	17.7%	9.9%
All Bonds	35.8	21.8	19.0	13.5	3.0	1.7	5.2
All Preferred Stocks	4.3	14.2	15.0	37.9	11.4	5.1	12.1
All Common Stocks	1.1	3.2	6.7	20.8	18.9	35.2	14.1
Governmentals:							
U. S. Gov. Bonds	100.0						
State and Mun. Bonds	40.1	21.8	16.5	12.3	3.2	1.9	4.2
Railroads:							
Bonds	24 2	20.7	31.8	15.3	3.9	2.0	2.1
Preferred Stocks	5.5	11.3	10.1	30.3	19.2	10.7	12.9
Common Stocks	0.0	0.2	0.8	8.3	18.9	66.5	5.3
Utilities:							
Bonds	40.4	27.1	18.3	8.2	1.9	0.6	3.5
Preferred Stocks	6.0	20.7	23.6	19.4	9.8	5.4	15.1
Common Stocks	2.1	6.4	16.8	30.3	20.7	17.6	6.1
Industrials:							
Bonds	18.5	17.8	20.0	18.4	3.4	1.6	20.3
Preferred Stocks	3.4	10.4	14.8	44.5	11.7	4.2	11.0
Common Stocks	0.2	1.2	5.2	16.4	16.1	43.0	17.9

The aggregate of all investments excluding real estate, real estate obligations, bank stocks, and miscellaneous, 43.5 per cent rated A or better, 46.6 per cent was below A quality, and 9.9 per cent was unrated. Since common stocks constituted nearly 50 per cent of the rated investments the average quality was consider-

ably lowered. The favorable showing was chiefly due to the high average quality of bonds.

THE CONSTANTLY CHANGING QUALITY OF INVESTMENTS.—Considerable portions of the trust investments comprising the composite fund do not excite admiration. Especially is this true when we recognize the unfavorable and unpromising conditions affecting many corporations, business, and governments which have necessitated a subsequent lowering of the ratings of many securities comprising the composite fund. Although the issues, in the aggregate, averaged fairly high at the time they were appraised, the intrinsic value of many items, especially in the stock classes, had suffered severely in the interval, thereby rendering these items unsuitable for investment. Such changes have clearly reduced to lower rating large numbers of bond and stock issues previously entitled to a place in the upper grades; correspondingly those in the lower grades have been increased.

Recent economic changes have radically altered investment conditions. They have raised a question concerning the adequacy of investment policies hitherto pursued. Such policies, perhaps, served well during a period of prosperity but doubt has arisen concerning their efficacy during these troubled times. The kaleidoscopic changes in the economic world of the last three years and their attendant hazards in the investment market have focused attention upon the dangers of any quiescent policy and the passive acceptance of the multitude of newborn risks and eminent losses. Investment policies, like investments themselves, must be judged according to their suitability for the purpose. They must be intrinsically sound, and imbued with fitness to meet specific but changing needs. Formal rules of procedure for the protection of invested funds are not sufficient. A flexible policy predicated upon a thorough knowledge of economic and business conditions as well as upon familiarity with specific securities, corporations, and industries must be invoked if those in charge of investments are to be successful in the conservation of principal and the maintenance of income.

Chapter XIV

THE INVESTMENT ACCOMPLISHMENT OF TRUST INSTITUTIONS

IN the investment of trust assets the trustee has a double obligation. First, the principal should be invested safely so that it shall remain intact. Second, the trustee should invest the trust property as productively as possible, consistent with safety, so as to obtain the maximum yield for the parties entitled to the income. In practice, the conservation of the principal of the trust has been considered the primary obligation of the trustee.[1] Although income is second in importance to the safety of the principal, there is less widespread recognition given to this idea. Due consideration, however, must be given this secondary obligation, for next to maintaining the principal, the investment earnings best measures the performance of trust institutions in handling trust property. Data heretofore presented on this subject have been rather incomplete and sketchy. In this study we have attempted to supply this deficiency through an analysis of income and principal of 196 trusts administered by eighteen trust institutions.

INCOME RETURN

Methods of Calculating Investment Income.—In calculating the income for the trusts in the different cities all available data were used. Due to a lack of usable data in some cities and the manner in which trust institutions presented the income figures, slightly different statistical methods had to be employed. It is believed, however, that the results are quite comparable. The way in which the income for each city was calculated is given below.

New York: In figuring the income for each trust, the average annual earnings of the trust were divided by the average annual principal of the trust. The yearly principal was based on the carrying value of the investments used by the trust institutions.

Boston: To determine the percentage earned for each year, the income for that year was divided by the principal for the

[1] Literature on trust investing is replete with this idea.

same year. The yearly principal was based on the book value of the investments as submitted to the probate court. Likewise the income figure used was the amount shown on the trust institution records submitted to the probate court. An average of all the years was taken as the percentage earned for each trust.

Chicago: The percentage earned for each trust was determined by selecting sample years, then taking the average of those years, the average covering five to ten years for each account. One or more years were selected in each of the following periods: (1) prior to 1921, (2) 1921 to 1926, (3) 1927 to 1932. The percentage earned was calculated by dividing the income for that year by the principal, which was based on the book value of the investments.

Cleveland: The percentage earned on the investment of each account was arrived at by taking sample years, and then an average of those years—the average covering from four to eight years. In figuring the percentage earned for each year, the income for that year was divided by the principal, which was based on the book value of the investments as submitted to the probate court.

St. Louis: Because of a paucity of usable data, only twelve trusts were analyzed as to earnings. In calculating the percentage of income for each trust, sample years were selected, five or more in each case. The income for each year selected was divided by the principal for that year, which was based on the carrying value of the investments. The average percentage for these years is regarded as the investment income for the particular trust.

INCOME RETURNS OF ONE HUNDRED NINETY TRUSTS.—The income data for all the trusts in the aggregate and classified according to the size of the individual trusts are presented in Table XXXVIII.

TABLE XXXVIII

INCOME RETURNS OF 190 TRUSTS AS AN AGGREGATE AND CLASSIFIED ACCORDING TO SIZE

Size of Trusts	Number of Trusts	Average Per Cent Earned on Investment (gross)
$ 0-$ 25,000	33	5.52
25,000- 75,000	49	6.06
75,000- 200,000	41	5.53
200,000- 500,000	41	5.66
500,000- 1,000,000	10	6.61
1,000,000 and over	16	6.55
Total	190	5.82

The data show quite a substantial return, when we consider that 5.82 per cent, even for gross income, represents the average income of different trusts for a period ranging from ten to thirty odd years. It is quite obvious that if the return had been figured throughout on the market value of the investments the percentage of return would have been different. Certainly this is true for the years 1930, 1931, and 1932, when the markets declined more rapidly than did the actual income received. In other words, the percentage of income would have been greater if figured on a market price base for these years[2] (and probably less for earlier years on the same basis).

EARNINGS OF DIFFERENT SIZED TRUSTS.—According to the evidence in Table XXXVIII there was no positive relationship between the earnings of the various trusts and the size of the account. The three classes ranging from $25,000 to $75,000, from $500,000 to $1,000,000 and of $1,000,000 or over gave the highest return, averaging over 6 per cent. The accounts in the groups above $500,000 for the most part contained larger proportions in common stocks and real estate; this undoubtedly accounts for the high return. In the class from $25,000 to $75,000 the high average return was primarily due to some four trusts which contained a high percentage of common stocks and real estate. These accounts had incomes ranging from 8 to nearly 14 per cent.

INCOME ACCOUNTING.—There was no absolutely uniform policy followed by all the trusts with respect to income accounting. In some cases the gross return from real estate greatly increased the average; in other instances non-cash dividends were counted as part of the return. However, less than 10 per cent of the trusts had their income distorted by these factors.

INCOME RETURN IN DIFFERENT CITIES.—The trust investment earnings of trust institutions in various cities did not differ greatly. The average percentage earned was as follows: New York, 5.9 per cent; Boston, 5.8 per cent; Chicago, 5.8 per cent; Cleveland, 5.8 per cent; and St. Louis, 5.6 per cent. There were no striking differences noted in the income of the various trusts regardless of size or city.

DISTRIBUTION OF TRUSTS ACCORDING TO INCOME.—In Table XXXIX on page 208 is shown the number of trusts arranged in groups according to per cent of income.

Thirty-three per cent of the trusts had incomes of less than 5 per cent; 33 per cent carried from 5.00 to 5.99 per cent; and 33 per cent earned 6 per cent or over. The most representative

[2] See *infra.*, p. 316 ff.

TABLE XXXIX

FREQUENCY DISTRIBUTION OF TRUSTS CLASSIFIED ACCORDING TO INCOME RETURN

Income	Number of Trusts
3.00-3.99	6
4.00-4.99	58
5.00-5.99	63
6.00-6.99	30
7.00-7.99	17
8.00 and over	16
Total	190

area of earnings was from 5.00 to 5.99 per cent, one-third of the total falling within this limited range. Thirty-three, or 17 per cent of the accounts showed an income of 7 per cent or over. These were apportioned among the different cities as follows: New York, fifteen; Boston, seven; Chicago, four; Cleveland, five; and St. Louis, two. In general, an analysis of these trusts shows that their assets were predominately composed of common stocks or real estate or a combination of these investments. The income of a large number of these trusts was considerably enhanced by stock dividends, stock rights, etc., or from real estate. In view of these facts, an average gross return of 5.8 per cent does not seem high. If this part of the income return had been deducted, the average return for the 190 trusts would probably have been considerably less than 5.82 per cent.

INCOME ON MARKET VALUE OF SECURITIES.—Since the preceding income data were predicated upon the carrying value of the investments—in most cases for the entire period of the trust —it is probably different from the income based on the market value of the securities. Undoubtedly the income data previously analyzed represent fairly accurately the return actually received by the beneficiaries, because it was based on the cost price of the investment. However, it is interesting to note the return on the market price of the investments during the last year for which data were collected.

The income on the market value of bonds and stocks, excluding real estate obligations, is set forth in Table XI on page 209.

The return of 6.08 per cent on the market value of bonds and stocks is indicative primarily of the situation in 1931 and 1932, as the calculations were made chiefly in those years. The low return on bonds results from the fact that 51.3 per cent of the bonds were United States government obligations, and state and municipals.

Measured on the base of market value, largely in depression

TABLE XL

CURRENT RETURN ON THE MARKET VALUE OF BONDS AND STOCKS IN 196 TRUSTS[a]

Class	Current Return
Bonds	5.58%
Preferred Stocks	7.76
Common Stocks	6.24
Composite of Bonds and Stocks	6.08

[a] For the end of the trusts.

years, for that portion of the trust investments represented by stocks and bonds, the income was considerably higher than the return on the composite of all investments for a long period on the ledger value of the trust assets. This figure, as previously noted, was 5.82 per cent. The difference is not so great as might be expected. However, it should be observed that many common stocks had ceased to pay dividends or had reduced the rate. Also the preferred stock dividend rate had been reduced or passed on some securities.

INCOME ON THE MARKET VALUE OF BONDS DISTRIBUTED ACCORDING TO THE FIELD OF INVESTMENT.—The return on the market value of the bonds of the composite assets by fields of investment is given in Table XLI.

TABLE XLI

CURRENT RETURN ON MARKET VALUE OF BONDS OF 196 TRUSTS BY FIELDS[a]

Field	Return
Railroad Bonds	5.98%
Utility Bonds	5.67
Industrial Bonds	6.66
United States Government Bonds	3.98
State and Municipal Bonds	5.46
Composite	5.58

[a] End of trusts.

The yields indicate the high quality of utility bonds. The higher return on rails, as compared with that on the utilities, is explained by the fact that railroads had been affected to a much greater extent by slow business. Consequently railroad bonds suffered declines in market value much more severe than utility issues. The return on utility bonds based on market prices as of 1931 and 1932 is a reflection of their high intrinsic quality. The high yield from industrial bonds corresponds closely to the degree of risk reflected by their grading. Government obligations require

no comment other than to say that the low yield of United States governments reflects their superior security and market ability. State and municipal bonds also show a low return caused, no doubt, by their general high quality and tax exemption feature. The intrinsic merit of many of these issues, however, had suffered considerably and their yields were correspondingly high.

CURRENT RETURN ON THE MARKET VALUE OF PREFERRED STOCKS ACCORDING TO THE FIELD OF INVESTMENT.—The productivity of preferred stocks based on market values for the composite fund by fields is exhibited in Table XLII.

TABLE XLII

CURRENT RETURN ON MARKET VALUE OF PREFERRED STOCKS OF 196 TRUSTS BY FIELDS[a]

Field	Return
Railroad	5.21%
Utility	7.38
Industrial	7.87
Composite	7.71

[a] For the end of the trusts.

The return on railroad preferreds is a reflection of the situation in the railroad field, in which preferred stocks were severely depressed. Industrial preferreds show quite a large return, the result of the business situation and the low average quality of these issues. Utility preferreds averaged considerably higher than rails in quality and the return was thereby lower.

INCOME ON THE MARKET VALUE OF COMMON STOCKS ACCORDING TO THE FIELD OF INVESTMENT.—Figures for returns on the market value of common stocks distributed according to the fields of investment are set forth in Table XLIII.

TABLE XLIII

CURRENT RETURN ON MARKET VALUE OF COMMON STOCKS OF 196 TRUSTS BY FIELDS[a]

Field	Return
Railroad	3.22%
Utility	6.88
Industrial	6.28
Bank and Insurance	5.91
Composite	6.24

[a] For the end of the trusts.

Income figures on market value of common stocks are highly deceptive, as they depend not only on rapidly fluctuating market prices, but also on inconstant rates of dividend payments. The index of common stock yields compiled by the Cleveland Trust

Company for all stocks traded in on the New York Stock Exchange for which there were reasonably regular quotations, and that paid dividends for a minimum of at least two successive years, showed a yield of 5.74 per cent in 1930, 7.43 per cent in 1931, and 9.59 per cent in 1932. In 1933 and thus far in 1934 the yield has been considerably reduced.

The current returns as reflected in Table XLIII are indicative of the effects of business conditions in the various fields during 1931 and 1932. Dividends were omitted on scores of issues, especially in the railroad and industrial fields. If the yields had been calculated solely in 1932 the composite average would have been lower than is shown in Table XLIII, due to the passing of dividends by many more corporations.

PRINCIPAL

PRINCIPAL OF THE TRUSTS.—Conservation of the principal of the trusts is everywhere regarded as the primary obligation of the trustee. In the last analysis it is the most significant aspect of trust institution investing, a standard by which we may largely judge the merits of trust investment work. The effect of the investment practices previously analyzed upon the principal of the trusts will next engage our attention. In order to determine how successful the trust institutions were in conserving or enhancing the principal, a statistical analysis was made of the gains and losses of the 196 trusts in question. The inventory value was used for the beginning of the accounts and the carrying value set up by the trust institutions was used for the end, or last year for which data were available.

NUMBER OF TRUSTS SHOWING AN INCREASE OR DECREASE IN PRINCIPAL.—The data showing the number of trusts having a gain or loss in principal, classified according to size and for all the trusts in the aggregate, are exhibited in Table XLIV.

TABLE XLIV

NUMBER OF TRUSTS SHOWING A GAIN OR LOSS IN PRINCIPAL

Size of Trusts	Total Number	Trusts Showing Gain in Prin.		Trusts Showing Loss in Prin.		Trusts Showing No Change	
		Number	Per Cent	Number	Per Cent	Number	Per Cent
$ 0-$ 25,000	36	26	72.2	9	25.0	1	2.8
25,000- 75,000	50	39	78.0	10	20.0	1	2.0
75,000- 200,000	42	28	66.7	14	33.3	0	0.0
200,000- 500,000	42	29	69.0	13	31.0	0	0.0
500,000- 1,000,000	10	7	70.0	3	30.0	0	0.0
1,000,000 and over.......	16	13	81.2	3	18.8	0	0.0
Total	196	142	72.4	52	26.6	2	1.0

The aggregate of all the trusts show fair success when judged by the fact that 72.4 per cent, or nearly three-fourths of the accounts enhanced their principal. These facts, however, should not be taken as the sole criteria for appraising the trust investment management of trust institutions. Due consideration should be given to the contents of the trusts when they were handed over to the trust institutions and to the legal restrictions surounding the management of these funds. To be sure, these factors cannot be measured exactly so that we can accurately appraise and credit the trust institution management for gains or losses. While admitting that these factors were important and considerably complicated the problem of trust investment management, they could have been surmounted if trust institutions had fully realized the importance of the investment end of their business. Further, it is shown in the following pages that the investments received from the testator were responsible for the increase in principal of a large number of the trusts. And although a majority of the decreases came from the investments received from the donor, the increases were far more significant. Thus it is felt that the results bring out the fact that the investment end of the trust business has been only moderately satisfactory. Since the trust institutions have fallen short on this part of their work, it may be attributed to the practice, common until recently, of considering administration all important in the trust business. If we consider only the investments selected by the trust institutions the appraisal would probably be more favorable. But shouldn't they be judged by what they did both with respect to what the trusts started with and with what the institutions selected?

PRINCIPAL GAINS OR LOSSES IN TRUSTS CLASSIFIED ACCORDING TO SIZE.—Classified according to size, the trusts show considerable variation in the per cent which gained or lost in principal. The groups below $75,000 and those of $1,000,000 or over made a better showing in the number having a gain in principal than the other groups as compared with the aggregate. The class of trusts of $1,000,000 or over, were, as an aggregate, the most successful in maintaining the principal; thirteen out of sixteen, or 81.2 per cent increased their principal. The trusts from $75,000 to $200,000 had the poorest record; fourteen out of forty-two, or 33.3 per cent, showed a depreciation. According to the data presented in Table XLIV there is no proof that size was controlling factor regarding the conservation of the principal.

In the different states, New York had fifty-nine out of eighty trusts, or 73.7 per cent showing a gain; two accounts had no change in principal; and fourteen, or 23.7 per cent suffered a

decrease. Thirty-two out of forty-one, or 78.0 per cent, of the Boston trusts increased their principal. The Chicago trust institution had only fifteen of the twenty-three accounts, or 65.2 per cent, which augmented their principal. Cleveland trust institutions increased the principal of twenty-three out of thirty-four trusts, or 67.6 per cent of the total. Of the eighteen trusts representing a St. Louis trust institution, thirteen, or 72.2 per cent increased.

PERCENTAGE CHANGE IN PRINCIPAL.—The total gain for all the trusts in the aggregate and for each city is set forth in Table XLV.

TABLE XLV

INCREASE IN PRINCIPAL ACCORDING TO CITIES AND FOR THE COMPOSITE OF 196 TRUSTS

Cities	Percentage Increase (Net)[a]
New York	18.1%
Boston	9.0
Chicago	58.6
Cleveland	47.2
St. Louis	7.8
Composite	27.4

[a] Based on book value of the principal.

The net increase in the principal of the composite assets was 27.4 per cent. Nine trusts, each over $1,000,000 in size, three from Chicago, three from Cleveland, and three from New York, contributed over 75 per cent of the total increase in principal made by the 142 accounts which showed a gain. This is explained by the fact that a small percentage gain in a $1,000,000 trust would have more weight on a volume basis than a much larger percentage increase in an account of, say, $50,000. When the trusts were classified according to size it was found that several groups were just as successful in augmenting their principal as was the class of $1,000,000 or over. If the trusts are analyzed individually and not as a composite it is seen that the accounts making the greatest percentage gain were all under $500,000 in size. However, the study of the various trusts does not show any definite correlation between the size of the account and the increase in principal.

Among the cities, the Chicago trusts as a composite showed the largest appreciation in principal, 58.6 per cent, and St. Louis the smallest, 7.8 per cent.

The individual trusts showed an increase in principal ranging from a fraction of 1 per cent to about 400 per cent. Most of the accounts, however, realized an increase of less than 10 per cent.

The losses varied from less than 1 per cent to about 66 per cent, the majority being around 5 per cent.

SOURCES OF INCREASES AND DECREASES IN PRINCIPAL.—Approximately 80 per cent of the total increase in principal for all the trusts in the aggregate came from common stocks; about 15 per cent was derived from real estate, principally from New York; the balance was contributed by bonds, preferred stocks, and real estate obligations. Of the 142 trusts showing an increase in principal, over 100, nearly 72 per cent, gained almost entirely from common stocks. Real estate was the principal factor responsible for gain in seventeen trusts.

The losses in the majority of the fifty-two trusts showing a decrease, came from common stocks. However, many accounts lost on preferred stocks, bonds, and real estate obligations. In most instances, the decrease in principal was due to investments received from the testator.

AN ANALYSIS OF INCREASES AND DECREASES IN EACH CITY—NEW YORK.—What were the particular reasons for the increase or decrease in the principal of the various trusts from the different cities? In New York two to three trusts contributed 70 per cent or more of the increase in each group when the trusts were classified according to size. In other words, thirteen trusts were responsible for approximately 75 per cent of the appreciation of the composite assets of eighty trusts. Seven of the thirteen gained almost entirely from common stocks and six from real estate. Although fifty-nine New York accounts showed an increase, twenty-seven accounted for approximately 98 per cent of the increment evident among all the trusts studied from that city. Sixteen of the twenty-seven trusts made increases from common stocks, ten from real estate, and one from other types of investment. It is interesting to note that the gains from three trusts, each over $1,000,000 in size amounted to a 11.1 per cent increase in principal for all the trusts in the aggregate, although the total gain from all the trusts combined equalled only 18.1 per cent—16.8 per cent after deducting administrative expenses.

Around 90 per cent of the increment in principal of the composite assets was derived from the investments received in trust from the testator, about 50 per cent of this increase came from common stocks and 40 per cent from real estate.

There were nineteen trusts showing a net loss from investments. Common stocks received from the grantor were responsible for the decrease of seven accounts. The remaining twelve trusts showed losses from various types of investment, no one kind being of major importance.

BOSTON.—The increase in principal of the thirty-two Boston trusts was derived very largely from common stocks, this type of investment accounting for around 95 per cent of the total increase in principal. Common stocks were clearly instrumental in augmenting the principal of twenty-six accounts. This type of investment was also of considerable importance in bringing about the increase shown by the other six trusts. No one trust contributed over 10 per cent of the gain shown by the composite fund.

There was a decrease in principal of nine Boston trusts. Two showed no loss from investing, the decrease being the result of administrative expenses. The losses in three trusts were principally from common stocks, preferred stocks accounting for the decrease in two. In only two trusts were there declines from investments actually made by the trust institutions. Fully 90 per cent of the decrease in principal resulted from investments received from the testator.

CHICAGO.—Of the Chicago trusts, each of the fifteen accounts showing an appreciation in principal contained a considerable proportion of common stocks. The trusts showing the highest percentage gain carried a large amount of common stocks. For example, each of the three trusts which increased over 100 per cent contained 50 per cent or more in common stocks throughout, except in 1931 and 1932. Over 90 per cent of the total gain in principal for all the trusts in the aggregate was contributed by four accounts, all containing a large amount of common stocks. Two trusts accounted for approximately 70 per cent of the increase of the composite fund, each listing over 90 per cent in this type of investment throughout the life of the trust. Since no stocks to speak of were purchased the appreciation in the various trusts came from securities received from the donor.

Eight trusts suffered losses, four chiefly as a result of the possession of common stocks. In each case where common stocks were the principal factor causing the decrease, they had been received from the testator. The remaining four accounts showing a loss contained no stocks.

CLEVELAND.—In general, stocks were responsible for more than 90 per cent of the total increase in principal of the composite assets of the Cleveland trusts studied. About 91 per cent of the total gain for all the trusts in the aggregate was derived from three accounts, two being over $1,000,000 in size and the third $338,000. The three trusts showing the largest percentage of gain contained a wide variety of investments, but each account averaged 50 per cent or more in stocks throughout the period

studied. Eleven trusts had an increase ranging from 5 to 100 per cent. Ten of these accounts averaged over 25 per cent in common stocks.

Eleven of the thirty-four trusts had a decrease in principal. Decreases in five of these accounts resulted from common stocks; each contained 50 per cent or more in this type of investment throughout. One trust lost on real estate, which constituted over 50 per cent of the trust assets in this account. The five remaining accounts which lost in principal also carried a substantial amount in stocks. However, stocks were not solely responsible for the decreases. Of the eleven trusts showing a loss, four decreased less than 5 per cent and in the remaining accounts the shrinkage ranged from about 10 to 30 per cent. The decrease for the trusts in the aggregate was less than 2 per cent of the principal at inventory value.

ST. LOUIS.—More than 90 per cent of the total gain for the St. Louis trusts as a composite came from common stocks. Of the thirteen accounts having a gain in principal, eleven derived their increase from stocks. The gains were primarily from investments made by the grantor which the trust institution retained.

Three of the five trusts suffering a loss in principal actually showed a small gain from investments but the decrease came from expenses. In the two remaining accounts the loss was the result of stocks, one preferred and one common, which had been received from the grantor.

Chapter XV

GOVERNMENTAL OBLIGATIONS AS TRUST INVESTMENTS

UNTIL quite recently, practically all government securities—Federal, state, and local—were regarded with the highest satisfaction as media for trustee investments. So far as the writer knows, every state having any legislation on the subject has by statute declared that Federal, state and municipal bonds are legal for the investment of trust funds.

Recently, however, the sharp contraction in municipal revenues, the major financial difficulties of some of our largest cities, as well as of hundreds of smaller municipalities, and the piling up of huge bonded indebtedness, have necessitated a careful analysis of the whole field of public finance, and a questioning of the merit of municipal obligations as proper investment for trust funds. Therefore it will be the purpose of this chapter to review the investment status of municipals.

Government Obligations in Trust Portfolios.—Before analyzing municipal securities in general let us briefly review the rôle of government obligations in the portfolios of 196 trusts from the five cities included in this study. Table XLVI exhibits the proportion of the aggregate principal invested in governmentals for the period 1919-1932.

TABLE XLVI

THE PERCENTAGE OF THE PRINCIPAL OF 196 TRUSTS INVESTED IN GOVERNMENT OBLIGATIONS, 1919-1932

Year	United States Bonds	State and Municipal Bonds	Total	Year	United States Bonds	State and Municipal Bonds	Total
Inv.	2.9%	3.5%	6.4%	1926	3.2%	10.3%	13.5%
1919	3.0	5.9	8.9	1927	1.7	10.3	12.0
1920	4.4	6.4	10.8	1928	1.3	10.5	11.8
1921	5.7	9.8	15.5	1929	1.6	10.9	12.5
1922	4.7	10.6	15.3	1930	2.0	11.3	13.3
1923	4.9	10.6	15.5	1931	2.5	13.6	16.1
1924	5.2	10.4	15.6	1932	3.1	14.1	17.2
1925	4.0	10.4	14.4	Av.	3.4	10.4	13.8

UNITED STATES OBLIGATIONS.—The position of United States government bonds in a trust portfolio should be determined by a consideration of these factors, namely, safety, marketability, yield, and possibly maturity. Most trust portfolios could afford to sacrifice a degree of safety and marketability exemplified in United States government bonds, for the sake of a higher income return. Obligations of the United States, however, might well be held by the average trust account, the percentage to be determined in part by the general business situation. It would have been a sound policy to have selected these bonds in considerable amounts early in the depression when so many other types of investment were becoming unsound.

Recently one trust institution official[1] in considering the ideal proportions of a well-balanced trust account of $1,000,000, stated that "at least 10% of such account should be invested in United States Government bonds." A survey of Table XLVI shows that this ideal was not put into practice by the trust institutions. The average amount in United States securities for the period 1919 to 1932 was only 3.4 per cent. In the study of trusts grouped according to size no group contained as much as 10 per cent in these obligations.

Among the individual accounts we note[2] that in the last year of the trusts only one account contained as much as 25 to 50 per cent in these bonds and only seven held from 10 to 25 per cent. Fifty-three of the seventy-three trusts listing United States securities had 5 per cent or less so invested.

The policy followed by the trust institutions was to invest a relatively small proportion in United States government bonds and vary the amount according to business conditions or the price of the bonds. Since United States government bonds are legal for all trusts (no instrument specified to the contrary) the trust institutions were free to change this item in the portfolios as conditions warranted. When the business situation became uncertain, as in the early twenties or in the early thirties, there was an accretion in these bonds. During the prosperous period of the second half of the twenties United States securities accounted for little of the aggregate principal.

STATE AND MUNICIPAL SECURITIES.—For many years state and municipal obligations have been regarded with high favor as trust investments. State bonds, especially, have ranked second to

[1] Evans, Arthur H., "Trust Investments and Policies," *Proceedings Eleventh Pacific Coast and Rocky Mountain States Trust Conference,* Oct. 26-27, 1933, p. 64.

[2] See Ch. XII, Table XXVII.

United States obligations with respect to safety and marketability. Municipal bonds in general have also long enjoyed a rating of high investment merit. This notion has prevailed so widely and so long as to engender a feeling that "any municipal bond is good if it is legal." Such a reputation plus the fact that municipal bonds are exempt from all Federal taxes, except inheritance taxes, and in many states from local taxes, have made most of them sell to yield a low rate of return; just a little more than United States government bonds but less than high-grade railroad or public utility bonds.

Although during recent years there has been some disillusionment to many investors in erstwhile high-grade "municipals," there are still available to the trustee substantial bonds in this field. The inclusion of some of these obligations in a trust portfolio would not be amiss. In fact the selection of certain state and municipal bonds would be a good policy, depending in part upon the state of business, the trust principal and the needs of the beneficiary. It has been suggested that 10 per cent would be a proper proportion.[3] In truth this percentage is what the composite data of the 196 trusts show. Eleven of the fourteen years, 1922 to 1932, showed a proportion of a little more than 10 per cent. The average for the fourteen years, 1919-1932, was 10.4 per cent.

There was no change in the number of accounts which invested in excess of 10 per cent of their principal in these bonds for the end period compared with the inventory. Nearly one-half of the trusts, twenty-nine out of sixty-one, contained less than 5 per cent in municipals at the end. About 15 per cent, nine out of sixty-one, contained 25 per cent or more, three containing over 50 per cent.[4]

Apparently the enormous increase in municipal debts and thereby the amount of municipal obligations outstanding during the period 1922 to 1929 had no appreciable influence upon the investment policy of the trust institutions. When the investment situation became uncertain as in the early twenties or as in the present upheaval, the investment proportion in municipals was promptly increased.

The total amount in government bonds showed a substantial increase from the inventory to 1919. The proportion was almost doubled from 1919 to 1932. For the most part the governmental obligations were substantial investments as shown by the ratings in Chapter XIII. Thus it would seem that the investment policy

[3] Evans, *op. cit.*
[4] See Chap. XII, Table XXVII.

of the trust institutions had been a fairly sound one with respect to governmentals.

THE SITUATION IN MUNICIPALS CALLS FOR A CRITICAL ATTITUDE.—The situation now prevailing in the municipal field necessitates a more realistic and critical attitude toward these bonds as proper investments for trust portfolios than has prevailed.

The comparatively satisfactory record which municipal securities has maintained for some decades fostered a feeling of implicit confidence in this class of securities. As a result investors paid little or no attention to the financial policies of municipalities. In particular they failed to consider changes in the nature of these securities which had been taking place since 1912. They did not check the ability of municipalities to meet their obligations entered into for expansion purposes. Neither did they analyze the legal entities being reared to foster borrowing capacity and to pile up huge overlapping indebtedness. They were too prone to accept, without further question, the figures shown in prospectuses for the sale of municipal obligations. But the sad state into which many of these obligations have fallen makes only too evident the problem confronting trustees in the administration of accounts involving this type of investment.

STATE AND MUNICIPAL DEBTS AND NATIONAL WEALTH.—During the past ten years particularly, local government units have been engaged in a spending spree, borrowing virtually to the limit of their capacity. From 1921 to 1933 for example, our states, cities, counties, and districts as an aggregate added more to their total bonded debt than in all previous years of their history. The extent of such borrowing may be seen from Table XLVII.

TABLE XLVII

STATE AND MUNICIPAL DEBTS AND NATIONAL WEALTH, 1912, 1922, 1932

Year	Total Debt[a] (000,000 omitted)	Per Capita Debts	National[b] Wealth (000,000 omitted)	National Wealth Per Capita	Ratio Debt to Wealth
1912	$ 3,822	$ 39.37	$186,300	$1,950	2.05%
1922	8,690	79.92	320,800	2,918	2.71
1932	17,597	140.77	247,300	1,981	7.12

[a] Bureau of the Census, *Financial Statistics of State and Local Governments.*

[b] National Industrial Conference Board, *The Conference Board Bulletin,* VII, 5, p. 34.

Thus far the twentieth century has seen a phenomenal growth in our state and local debts. From 1902 to 1912 there was an

increase of $1,950 million which was greater than the total debt at the turn of the century. The period 1912 to 1922 represents an increase of $4,868 million or a rise of 127 per cent. The next decade showed a further increase of $8,907 million or 103 per cent. These figures become more impressive when we consider that the per capita growth in debt more than tripled in the period 1912 to 1932, rising from $39.37 to $140.77.

A comparison of the total state and local debt to national wealth reveals a striking change in the last two decades. The ratio of debt to wealth was 2.05 per cent in 1912. In 1922 the ratio was 2.71 per cent and in 1932, 7.12 per cent. In other

TABLE XLVIII

STATE AND LOCAL DEBT, ASSESSED VALUATION AND WEALTH PER CAPITA OF VARIOUS STATES, 1932[a]

State	Total State and Local Debt (000 omitted)	Debt per Capita	Assessed Valuation of all Property (000 omitted)	Wealth per Capita[b]	Ratio of Debt to Wealth
California	$1,099,416	$186.15	$ 7,951,085	$2,692	6.90%
Colorado	129,504	123.81	1,447,170	3,165	3.91
Connecticut	160,700	98.59	3,151,284	3,389	2.90
Florida	513,023	337.74	520,454	1,710	19.75
Georgia	106,986	36.76	1,267,790	1,377	2.68
Illinois	819,640	104.80	7,875,677	2,958	3.54
Indiana	199,035	60.87	5,073,241	2,786	2.17
Iowa	241,991	97.66	1,463,741	4,322	2.26
Louisiana	360,410	169.05	1,666,140	1,662	10.18
Maryland	261,168	158.28	2,761,587	2,596	6.07
Massachusetts	436,600	101.77	7,442,795	3,144	3.24
Michigan	769,911	152.62	8,262,000	2,419	6.96
Minnesota	285,111	110.42	2,307,881	3,403	3.24
Missouri	359,407	98.00	4,566,000	2,819	3.48
New Jersey	1,151,231	278.61	6,819,527	2,990	9.31
New York	3,477,233	271.40	29,559,936	2,987	9.08
North Carolina	507,683	154.00	2,831,000	1,482	10.41
Ohio	875,036	129.89	13,452,947	2,859	4.54
Oklahoma	194,085	79.77	1,753,601	1,683	4.76
Pennsylvania	1,213,706	124.82	12,762,317	3,068	4.07
Tennessee	323,496	122.30	1,663,892	1,667	7.30
Texas	662,232	109.76	3,962,841	1,720	6.39
Washington	217,431	137.27	1,250,040	3,342	4.10
Wisconsin	205,234	69.10	5,073,701	2,744	2.52

[a] Compiled from the Bureau of the Census, *Financial Statistics of State and Local Governments,* 1931-1932. Debt figure for Illinois and Missouri from Van Riper, Walker, "Are Municipal Bonds Investments," *Barron's,* March 5, 1934.

[b] Figures from Industrial Conference Board for 1930.

words our state and local debts have grown much faster than has our national wealth, especially since 1922.

DEBT, ASSESSED VALUATION AND WEALTH PER CAPITA OF VARIOUS STATES.—The debt situation in various states for the year 1931 or 1932 is exhibited in Table XLVIII on page 221.

From 1922 to 1932 the percentage change in state and local debts ranged from a decrease of 10 per cent in North Dakota to an increase of 431 per cent in Florida. Approximately one-third of the states showed an increase of over 100 per cent, while over one-half had an increase of 50 per cent to 100 per cent.

Theoretically assessed valuation should be, in general, a measure of debt paying capacity since it is the basis for taxation. Taxation, of course, is the basic factor determining the value of state and municipal bond issues. Assessed valuations, however, show great variations from state to state and are unsuitable for comparative purposes.

REVENUES AND INTEREST.—Table XLIX shows the total revenues of various states which are for the purpose of defraying all governmental costs. Interest figures are also given for

TABLE XLIX

REVENUE RECEIPTS AND INTEREST ON DEBT OF VARIOUS STATES, 1932[a]

State	Revenue Receipts (000 omitted)	Interest on State and Local Debt (000 omitted)
California	$ 631,049	$ 53,292
Colorado	84,779	5,692
Connecticut	128,222	7,906
Florida	106,585	21,361
Georgia	99,829	5,638
Indiana	221,547	10,320
Iowa	192,060	11,428
Louisiana	103,352	16,276
Maryland	104,599	12,086
Massachusetts	384,018	20,734
Minnesota	216,856	16,211
New Jersey	427,706	54,870
New York	1,388,734	145,743
Ohio	506,535	50,205
Oklahoma	116,491	12,468
Pennsylvania	626,563	59,007
Tennessee	98,398	16,133
Washington	144,230	10,626
Wisconsin	256,457	9,191

[a] Compiled from the Bureau of the Census, *Financial Statistics of State and Local Governments,* 1931-1932.

the same states showing the proportion interest on debt is of total revenues. Debt service cost would be much greater if debt retirements were also included.

DEBT PAYING POLICY OF VARIOUS STATES.—Further significant data pertaining to state and local debts dealing with the extinction of indebtedness are shown in Table L.

TABLE L

THE DEBT PAYING POLICIES OF VARIOUS STATES, 1926-1932[a]

(000 omitted)

State	Average Total Debt 1926-32	Amount Matured	Total Net Amount Paid	Average Amount Paid Annually	Ratio Paid to Amount Outstand.	Total Refunded Issues 1926-32	Ratio Refunded to Amount Matured
California	$1,006,332	$171,595	$170,876	$28,479	2.83%	$ 719	0.42%
Colorado	175,879	17,944	16,190	2,697	1.53	1,754	9.77
Connecticut	143,949	31,997	29,799	4,966	3.45	2,198	6.87
Florida	440,381	54,164	35,872	5,979	1.36	18,292	33.78
Georgia	77,606	16,311	15,250	2,541	3.28	1,061	6.51
Illinois	701,651	159,508	142,248	23,708	3.38	17,260	10.82
Indiana	239,490	32,209	29,818	4,969	2.07	2,391	7.43
Iowa	260,059	42,080	35,936	5,989	2.30	6,744	15.80
Louisiana	246,964	38,714	38,629	6,438	2.61	85	0.22
Maryland	211,667	55,650	54,914	9,152	4.32	736	1.32
Mass'usetts	391,865	162,220	138,220	23,037	5.87	24,000	14.82
Michigan	758,328	113,643	75,980	12,663	1.67	37,663	33.15
Minnesota	370,865	77,371	74,530	12,421	3.35	2,841	3.67
Missouri	296,396	64,169	63,346	10,557	3.56	823	1.28
New Jersey	871,759	182,241	180,259	30,043	3.44	1,982	1.08
New York	2,947,875	502,298	485,485	80,914	2.74	16,813	3.35
No. Carolina	449,230	71,924	65,041	10,830	2.41	6,883	9.57
Ohio	904,966	289,420	276,608	46,101	5.09	12,812	4 43
Oklahoma	177,616	16,605	16,455	2,743	1.54	150	0.90
Penn'lvania	1,120,506	136,211	132,162	22,027	1.96	4,049	2.97
Tennessee	242,900	41,413	20,570	3,428	1.41	20,943	50.60
Texas	658,656	64,422	47,336	7,889	1.19	17,086	26.50
Washington	238,900	66,891	63,646	10,608	4.44	3,245	4.85
Wisconsin	173,870	39,463	37,663	6,277	3.61	1,800	4.56

[a] Walker Van Riper, "Are Municipal Bonds Investments?" *Barron's*, March 19, 1934.

Refunding may or may not be a good policy. If it is to convert optional, but not yet due, debts into new issues bearing more favorable terms, then it is a sound practice. If the refunding is for the purpose of meeting actual debts that are due it may be unsound, especially if there is a refunding of a comparatively large proportion of the bonds which mature. Of the states not shown in Table L eleven had a ratio of refunding to the total amount matured of over 25 per cent, five of these had a ratio of over 50 per cent. Four of the states listed in Table L had a ratio of over 25 per cent. Sixteen states shown in this Table refunded

less than 10 per cent of the amount matured in the period 1926-1932.

DEBTS, DEBT SERVICE AND INCOME.—The relationship of state and local debts and the debt service thereon to the national income is set forth in Table LI.

TABLE LI

STATE AND LOCAL DEBTS, DEBT SERVICE AND NATIONAL INCOME, 1922, 1929, 1932

Year	Total Debt[a] (000,000 omitted)	National Income[b] (000,000 omitted)	Debt[d] Service (000,000 omitted)	Ratio of Debt Service to Income	Ratio of Debt to Income
1922	$ 8,690	$65,925[c]	$ 851	1.29%	13.03%
1929	16,556[a]	81,136	1,292	1.59	20.43
1932	17,597	48,894	1,494	3.05	35.95

[a] See Table XLVII.
[b] Bureau of Foreign and Domestic Commerce, *National Income, 1929-32,* 73d Congress, 2d Sess., Senate Document No. 124, p. 10.
[c] King, W. I., *The National Income and Its Purchasing Power,* p. 77.
[d] Evans, Clark, *The Internal Debts of the United States,* (1933), p. 258. (Includes interest charges and debt retirements.)

The data show a definite increase in the ratio of debt service to the national income, rising from 1.29 per cent in 1922 to 3.05 per cent in 1932. The debt burden is increased due to the fixed nature of debt charges, the decrease in the national income, and the shrinkage in our national wealth. If the debt service of municipal debts were related to the income of the urban population the ratio would be considerably higher than is shown in Table LI.

TAXABLE WEALTH, TAXES AND DEBTS.—Until the early twenties taxable wealth tended to rise as rapidly as did state and local debts. From 1922 to 1932 the ratio of debt to wealth began to show a considerable increase. With wealth decreasing during the depression the per cent of debt to taxable wealth jumped to the highest figure in our history, the total debt becoming approximately 7 per cent of taxable wealth in 1932.[5]

Taxes have increased almost as rapidly as has state and local debts. Total taxes showed a pronounced rise from 1922 to 1932 and in consequence the ratio of taxes to wealth and to income was substantially larger in 1932 than in 1922.[6] Not only have

[5] See Federal Committee Report on *Double Taxation* and the Bureau of the Census, *Wealth, Debt and Taxation.*
[6] *Ibid.*

taxes been increased but in recent years tax delinquencies and uncollected taxes have greatly increased.

DEFAULTS.—State and local bonds had been virtually free of default in either interest or principal for decades. In recent years the picture has changed. It is estimated that up to February 1, 1933, more than 1,100 governmental units had defaulted on bonds[7] aggregating $1,200,000,000.[8] Undoubtedly scores of other issues are on the brink. Defaults had become so common that only six states reported no defaults. Eleven states reported one to five defaults; twenty-six six to fifty; and five fifty-one to one hundred fifty defaults.[9] Defaults have occurred most frequently in those states having rapidly increasing debts.

The types of obligations which have chiefly been instrumental in disrupting municipal finance and causing defaults are anticipatory notes, short term loans, and special assessment bonds. While there was an increase in wealth and income these obligations created no particular problems. But they proved hazardous during a depression when property values fell, incomes shrank and tax delinquencies increased.[10]

OVERLAPPING DEBTS.[11]—Although one state and a number of outstanding cities have defaulted on their obligations, the major difficulties are with various districts, small municipalities, and political subdivisions—governmental units created for the purpose of increasing the borrowing capacity of the area. In fact, overlapping indebtedness entered into as a means of promoting new taxing entities within other governmental areas has been a major factor in the instability of municipal securities. In the majority of states there are no effective limitations on the practice. Although a few states impose debt limitations for municipal subdivisions, they are frequently of little value, or they are of such a nature as almost to compel evasion. If a city is already bonded to the legal limit, and wishes to build a new school, a new district will have to be devised which has a separate debt limit. Thus oftimes, municipal debt is far out of proportion to the assessed value of the property and yet its obligations are not disqualified for trust investment.

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[7] Clark, Evans, *The Internal Debts of the United States*, (1933), p. 270.

[8] Public Administration Service, *Municipal Debt Defaults*, (1933), p. 1.

[9] Kilpatrick, Wylie, "When Municipalities Go Bankrupt," *Barron's*, May 1, 1933.

[10] Clark, *op. cit.* p. 271; Public Administration Service, *Municipal Debt Defaults*, (1933), Ch. III.

[11] Kirshman, J. E., *Principles of Investment*, 2d ed. (1933), Ch. XXXIV; Riley, E. J., "Municipal Obligations as Trust Investments," *Trust Companies*, Vol. LIV (March, 1932).

The existence of overlapping tax areas greatly complicates the problem of analyzing municipal obligations. The chief danger lies in the complete uncertainty regarding the security behind such obligations. Prospectuses of any particular road district, school district, or other legal entity show the assessed value of property in the district, its approximate valuation and net debt clearly enough, but fail to indicate the ultimate extent of additional liability. At present it is frequently impossible to get accurate or adequate information about the financial condition of municipalities and political subdivisions.

DIFFICULTY IN SECURING FUNDS.—One of the chief reasons for the collapse in public credit is the manner in which the typical municipality has handled its current finances. It has financed its improvements through bond issues and has raised current funds through bank loans, but now many have had to use what cash they had on hand, and have anticipated taxes to the limit. With many municipalities unable to sell any bonds at all, scores of cities are having difficulty with payrolls and fixed charges.[12] The distressed state of the municipal bond market is best typified by New York City, which, after much difficulty, finally sold some 3-5 year notes on a 6 per cent basis, whereas in May 1931, it was able to sell 3 per cent long-term bonds. Philadelphia has had to sell its bonds over the counter, and Chicago has seen a large part of its tax-anticipation warrants remain unsold. In fact, bonds of scores of our cities have gone begging. Until the statistical position of our municipal debt is improved by readjustment to actual facts, many municipalities will continue to have difficulty in disposing of their bonds. Raising necessary taxes to meet expenses is most difficult because of the business situation. In truth, cities all over the country are having difficulty in securing funds.

PROGRAM OF RETRENCHMENT.—Realizing at last that they have jeopardized their credit by their debt and financial policies, numbers of cities have recently adopted a policy of serious retrenchment. Detroit was one of the first to recognize the dangers of its reckless extravagance and the serious predicament of its finances. In 1931 it began to put its house in order by providing for a quarterly readjustment of the 1931-1932 budget. Its tax budget for 1932-1933 was reduced by $4,000,000. New York, Chicago, Philadelphia, Cleveland and other large cities wisely adopted a program of retrenchment and budgetary

[12] "Financial Embarrassment of Our Leading Cities," *Engineering News Record,* February 25, 1932. For a continuation of this discussion see this and the following numbers of the *Engineering News Record.*

reform. Many other cities likewise cut their budgets and curtailed expenditures. In many states there was a widespread movement for curtailed expenditures.[13]

SINKING FUND PROBLEM.—Such paring of budgets is a most encouraging move, but by itself this will not be sufficient to make municipal obligations safe media for trust funds. The financial administration of many cities is yet poor, and the scant attention given to the use of sinking funds detracts from the investment quality of municipal obligations. A major factor aggravating municipal finances is the maturing of bonds for which no provision has been made. Yet, it is of the utmost importance to the investor to know something about these sinking funds, how large they are, in what securities they are invested, and whether the schedule of payments is rigidly adhered to.[14]

An outstanding example of the abuse of the sinking fund is that presented by the Tennessee State Tax Commission in its 1930 Report: "Sinking funds in a few counties where they exist are not well managed. In one county . . . some officials constituted themselves as a sinking fund commission and lent the whole amount on real estate mortgages. In another . . . the assets were loaned to one of the commissioners, who lost it through unwise investment. . . ." It is doubted "if the sinking funds amount to 5 per cent of the total debt. In fact, few county officials intend to amortize the debts as they fall due. . . ." Such practices are intolerable but they are fairly obvious. Other methods are more subtle, such as dissipating assets through the so-called "investment" in new permanent improvements. The excuse offered for this practice is not sound economic reasoning; maturing bonds cannot be paid with permanent improvements.

That the situation is not altogether hopeless, however, is indicated from the excellent results obtained where certain state governments have actually taken definite steps to control the affairs of various subdivisions.[15] One of the first important instances of this kind was the action of West Virginia in 1921, in forming a State Commission to administer local sinking funds. Within recent years, the West Virginia legislature has passed bills providing additional funds in the event some of the local units find

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[13] Broderick, John P., "The Cities Go Thrifty," *Barron's*, May 30, 1932.

[14] Colby, Benjamin, "The Importance of Sinking Funds to Tax Exempts; Examples, Good and Bad," *The Annalist*, July 15, 1932, p. 71.

[15] See Act of the Legislature of West Virginia creating the State Sinking Fund Commission, Ch. 157, Acts of 1921; Reports of the State Sinking Fund Commission; Bond, John C., "Municipal Bonds in West Virginia," speech delivered at the convention of the National Association of State Auditors, etc., November 19, 1925.

it difficult to meet their obligations. The prize example of state control, today, is that of North Carolina, whose Local Government Commission supervises all units of the state both as to sinking funds and new borrowings. Already, its beneficial effects have been felt. Although some refunding is still necessary it is strictly regulated. There are, too, many municipalities which have a sound sinking fund administration.

The alarming increase in the municipal debt burden in the face of a shrinkage in property values and incomes, from which taxes must be collected, created a nation-wide problem. Recognizing the danger, should this continue, the Investment Bankers Association drew up a definite program to help municipalities meet their difficulties.[16] In cooperation with the American Bankers Association and the Association of Life Insurance Presidents, the Municipal Securities Committee of the Investment Bankers Association also fostered a movement for a central organization to study the financial condition of municipalities.

The Municipal Securities Committee likewise attempted to develop a Uniform Special Assessment Bond Law, which it hoped would serve as a guide for future laws affecting securities issued in connection with special assessments. The serious abuses of special assessments have been responsible for much of the trouble in which municipalities find themselves today. The proposed legislation would suggest the proper limits to eliminate various unsound practices in the issuing of bonds. Such efforts, while by no means a panacea for all the ills to which municipal financing is subject, nevertheless should help toward restoring municipal credit to a much sounder basis.

At the present time, there has not been worked out a satisfactory method of preventing municipal bankruptcies or intelligently controlling or supervising municipal finances. Neither has there been worked out machinery for adequately handling the finances and obligations of defaulting municipalities. Progress is being made, however, as steps are being taken in various states to adjust debts, to set up receiverships or other methods to supervise the finances of defaulting municipalities, and to pass laws to bring about more satisfactory control over municipal budgets.

[16] *Investment Banking,* June 3, 1932; Hart, Henry, "Interim Report of Municipal Securities Committee," *Investment Banking,* June 14, 1932, p. 236 ff.

Chapter XVI

REAL ESTATE OBLIGATIONS AS TRUST INVESTMENTS

DURING the period from 1921 to 1929, especially, lavish amounts of money from various sources all over the United States were poured into city real estate mortgages and bonds. Millions of investors bought real estate obligations and many investment houses and banks were convinced that next to United States government bonds, the prime security was real estate. Such obligations qualify in every state as proper for trust investments. If there has been any legislation on the subject it has authorized the selection of such securities.

However, overbuilding and speculation, with the consequent decline in real estate values have been the inevitable results of unintelligent and profligate lending policies. Now that a reversal in economic affairs has occurred, the deflation in real estate securities has created an unprecedented state of affairs in this field.

What was the rôle of trust institutions in this situation? And what is the present status of their real estate holdings? It is not possible to give definite answers to these questions, but there are sufficient data at hand to throw some light upon them. The present depressed condition of real estate is a source of great concern to trust institutions, because a large proportion of their trust accounts is invested in real estate obligations.

URBAN REAL ESTATE OBLIGATIONS IN TRUST PORTFOLIOS.—The amount of urban real estate obligations outstanding in the United States has been estimated at $35,000,000,000.[1] The exact amount of such credit held by the personal trust department of trust institutions is not known, but from available evidence the writer believes that these investments total billions of dollars. Regardless of the exact amount of real estate obligations held by trust institutions, the volume is large, and comprises an important percentage of the urban mortgage credit outstanding. The data of 196 trusts from five cities show that the proportion allocated to this item in 1932 was more than double the amount held in the inventory, taking the relative dollar volume for the aggregate.

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[1] Clark, Evans, *The Internal Debt of the United States,* (1933), p. 66.

The relative proportion of trust assets in various types of real estate investments from 1919 to 1932 is shown in Table LII.

TABLE LII

THE PROPORTION OF TRUST INVESTMENTS IN REAL ESTATE AND REAL ESTATE OBLIGATIONS, 1919-1932

Year	Urban Real Estate Oblig.	Land Bank Bonds	Real Estate	Total
1919	16.5%	0.0%	17.0%	33.5%
1920	15.9	0.0	16.9	32.8
1921	13.5	0.1	14.8	28.4
1922	13.0	0.9	13.6	27.5
1923	13.1	1.8	12.2	27.1
1924	13.0	1.8	11.8	26.6
1925	16.3	2.4	11.8	30.5
1926	17.5	2.4	11.4	31.3
1927	18.9	2.4	11.0	32.3
1928	19.1	2.8	8.8	30.7
1929	21.5	3.0	6.2	30.7
1930	22.0	3.1	5.1	30.2
1931	22.6	2.2	3.8	28.6
1932	22.3	2.0	3.0	27.3

URBAN MORTGAGES AS TRUST INVESTMENT.—Today real property as security for long-term loans comprises a major field of investment. In fact obligations secured by urban real estate constitute one of the most widely accepted fields for trust investment. Literature in the trust field frequently asserts that real estate mortgages, when conservatively made and selected, are superior as trust investments to all other types of legal investments.[2] To a large extent this attitude is undoubtedly due to the traditional preference for mortgages, a practice handed down from the early history of our country's development. In a young and growing country such as the United States has been, mortgages have been one of the highest types of security. Until recent years the investment record of such investments has been unusually favorable with respect to both safety and income. They are still a good investment for trust institutions if they are well selected and properly supervised. Such investments will provide a trust portfolio with security of the first degree and an income above that obtainable from high-grade bonds.

[2] Bennett, R. A., "Real Estate Mortgages Retain Pre-Eminence as Investments for Trust Funds," *Trust Companies*, Vol. 55, (July, 1932), p. 55.

POLICY OF TRUST INSTITUTIONS.—Although the disastrous experience of recent years has cast reflection upon real property securities they are still considered an excellent trust investment. Thus we wish to know what has been the practice of trust institutions with respect to this type of investment. Recently in considering a well-balanced program for a $1,000,000 account, high grade mortgages to the amount of 10 per cent of the trust were recommended.[3] The data of Table LII show a higher percentage than this for the composite of 196 trusts. In no year did the aggregate of all the trusts show less than 13 per cent in urban real estate obligations. From 1929 to 1932 the amount so invested was over 20 per cent. The average for the fourteen years, 1919-1932, was 17.4 per cent.

The sixteen trusts of $1,000,000 or over held more than 10 per cent as an average in this type of investment.[4] For four years, 1921-1924, the proportion was less than this amount but in 1929-1931 this item composed more than 20 per cent of the total principal in this group. The trusts of less than $75,000 held over 40 per cent in real property securities for the period 1927-1931.

The policy of trust institutions was distinctly one of increasing the amount of trust principal in urban real estate securities. Between the time the trusts were received and 1919, the proportion in such investments had been nearly doubled. The decrease in real estate obligations for the years 1920 to 1924 seems to coincide fairly accurately with the increase in governmentals during the same time. From 1924 to 1931 the percentage in this type of investment was substantially increased, rising from 13 per cent to 22.6 per cent. The striking growth in real estate obligations during this time paralleled the real estate boom of the twenties. This investment was the largest single item in the composite of 196 trusts with the exception of industrial common stock.

The position of real estate obligations is best seen from an examination of individual trusts. The number of accounts selecting these obligations increased from ninety in the inventory to 168 in the last year for which the trusts were studied. This type of investment was held in 40 per cent more trusts than contained any other item. Fifty-seven, or nearly 30 per cent, of the trusts had 50 per cent or more of their principal invested in securities

[3] Evans, Arthur H., "Trust Investments and Policies," *Proceedings Eleventh Pacific Coast and Rocky Mountain Trust Conference,* Oct. 26-27, 1933, p. 67.

[4] See Ch. XI, Table XXVI.

based on real estate. An additional twenty-nine, or 15 per cent, had from 25 per cent to 50 per cent so invested.[5]

THE POLICY IN NEW YORK.—In New York, the predominant center of the trust business, the proportion of trust investments carried in real estate obligations was very large. The New York trusts as an aggregate held over 30 per cent of their principal in these items each year from 1928 to 1932. When the eighty trusts terminated, thirty-four contained over 50 per cent of their assets in real estate mortgages or bonds, and four held this proportion in real estate proper. There was a pronounced increase in the holdings of real estate securities in the New York trusts from the time they were received by the trust institutions until the last year for which data were collected.

LAND BANK BONDS.—Joint Stock Land Bank bonds comprised practically all of this group. These securities were held almost entirely by the Cleveland trusts. They amounted to less than one per cent of the principal in the inventory of the accounts. By 1923 the proportion had been increased to over 3 per cent and in 1928, over 8 per cent of the Cleveland assets were so invested. From 1928 to 1932 the proportion had been decreased to about 4 per cent.

In view of the set-up and experience of the Joint Stock Land Banks it is difficult to understand why trust institutions should choose these bonds. Such bonds have sold at a heavy discount during the years of the depression. A number of these banks have defaulted on the interest of their bonds and have been placed in receivership.

REAL PROPERTY.—Although real estate proper comprised an important percentage of the total trust principal, it was all received in trust from the grantors. It is not considered suitable for trust investment, and so far as the writer knows it is not authorized as such in any state.

The policy of the trust institutions has been to dispose of the real estate rather gradually. In the inventory it was listed in fifty-four trusts and in the last year of accounting it was still being held by thirty-one accounts. The proportion so invested, however, was drastically reduced.

COMPARISON WITH LIFE INSURANCE COMPANIES AND SAVINGS BANKS.—It is interesting to compare the policy of trust institutions in our leading cities with the recent tendencies among life insurance companies. These comparisons are made in Table LIII.

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[5] See Ch. XII, Table XXVII.

TABLE LIII

COMPARATIVE PROPORTION OF TOTAL INVESTMENTS IN CITY REAL ESTATE OBLIGATIONS

Year	LIFE INSURANCE COMPANIES[a] City Mortgages	TRUST INSTITUTIONS Urban Real Estate Obligations
1928	29.2%	19.1%
1929	30.0	21.5
1930	29.6	22.0
1931	28.5	22.6
1932	27.5	22.3

[a] *Proceedings of the Twenty-Sixth Annual Convention of the Association of Life Insurance Presidents,* (1932), p. 108.

Further evidence of the policy among life insurance companies may be seen from the fact that the volume of urban mortgage loans has increased less rapidly for the past six years than certain other types of investment. For example, the percentage increase in city mortgage loans rose steadily from 1919 to 1929, but since 1929 it has been steadily decreasing.[6] Of the new investments made by life insurance companies in 1930, 45 per cent was in city mortgage loans; in 1931 the figure was 36.5 per cent; and in 1932 it was 31.8 per cent.

Comparable data for savings banks as a whole are not available, but a glance at the investment policy of savings banks in New York will throw some light on the situation. Although real estate mortgage investments are still the largest single investment of savings banks in New York, the proportion invested in such securities has declined in recent years. According to the 1931 report of the Superintendent of Banks in that state, only 59 per cent of the resources of New York savings banks were in mortgages, compared with 63 per cent the year before. From 1930 to 1931 there was a gain of over $600,000,000 in total resources, but a net increase in mortgages of only $187,000,000.

URBAN REAL ESTATE FINANCING.—The decade of the twenties was the boom period of urban real estate financing. It was a time of intense optimism and too frequently one of blind faith. Strenuous efforts were made to attract capital to the real estate field even though this resulted in securing money which should never have been invested in real estate securities. Extraordinary sales and promotional methods were devised. The prestige of the word "mortgage" was played upon; the concept that

[6] *Proceedings of the Twenty-Sixth Annual Convention of the Association of Life Insurance Presidents,* (1932), p. 108.

mortgage bonds were just like any other bonds was emphasized; the generous yields of mortgages and mortgage bonds over other high grade investments was stressed; and these obligations were frequently sold under the guise of being readily marketable. Consequently millions of investors and most investing institutions bought real estate securities. Believing that such investments were prime security, many bought to the limit of their capacity.

Many issues which these investors purchased were based on high appraisal values. The conservative ratio of 50 per cent of the appraisal value for a mortgage loan had been pushed up to 60 per cent, 75 per cent, 90 per cent, and in some instances, 100 per cent.

Not only were these securities frequently sold on a ratio of high appraisal values but they were also sold without supplying the investor with any substantial information. Real estate bonds especially carried a dearth of information. In consequence few of them have been given a rating by the investment services.

The passing of huge sums of capital into the real estate field was an instigating factor in the marked overbuilding during the decade of the twenties. This led to a decline in revenue from property and a consequent fall in real estate values. These adverse factors, of course, were intensified by the depression. Thus there has been a decided drop in price of a large proportion of real estate securities. In fact a large percentage of such issues are more or less in distress.

VOLUME OF BUILDING.—Construction contracts awarded, as a measure of the quantity of building in the United States, including residential and non-residential, are shown in Table LIV.

TABLE LIV

CONSTRUCTION CONTRACTS AWARDED IN THE UNITED STATES, 1913-1932[a]

(000 omitted)

Year	All Building	Residential	Commercial
1913	$ 857,700	......	......
1919	2,579,881	$ 849,206	......
1921	2,360,189	877,870	$338,028
1926	6,380,900	2,671,100	920,900
1929	5,750,800	1,915,700	929,200
1932	1,351,200	280,100	122,700

[a] F. W. Dodge Corporation. For 37 States, including small towns and rural districts. Prior to May, 1921, 25 states; 1921, 27 states.

The volume of building was very low during the war period, particularly in 1918. By 1919 there was a serious shortage of

buildings and construction began but was interrupted by the depression of 1920-1921. Following this period there was a decided demand for construction. The favorable factors giving rise to the increased building activity were a shortage of buildings, a comparatively small indebtedness, and rising business activity. For the next decade building was very active, resulting in an average expenditure during the years 1921 to 1930 of over $5,000,000,000 annually. Since 1929 there has been a drastic decline in building activity, extending to April, 1933. There has been considerable recovery, however, in the volume of construction contracts awarded since April, 1933.

NATIONAL INCOME, URBAN POPULATION AND BUILDING.—The rate of growth of building compared with the national income and urban population is set forth in Table LV.

TABLE LV

TREND OF BUILDING, URBAN POPULATION AND NATIONAL INCOME, 1913-1932

(000,000 omitted)

Year	Building Contracts Awarded[a]	Urban Population[b]	National Income[c]
1913	$ 858	45	$34,400[d]
1921	2,360	55	54,600[d]
1929	5,751	68	81,136
1932	1,351	71	48,894

[a] F. W. Dodge Corporation. See Table LIV.
[b] Bureau of the Census. Inter-census years are estimated.
[c] Department of Commerce, Bureau of Foreign and Domestic Commerce, *National Income, 1929-1932.*
[d] National Industrial Conference Board.

Building was relatively slow from 1913 to 1921. For the same period the national income shows a large gain but if it is expressed in terms of 1913 dollars it really decreases slightly. On the other hand, urban population increased 22 per cent. From 1921 to 1929 building increased a great deal faster than national income or urban population.

URBAN MORTGAGE DEBT.—A picture of the urban real estate debt in the United States and the sources of funds is shown in Table LVI on page 236,

These figures cover the various fields for which fairly accurate data are available, but they do not include all the urban mortgages and real estate securities. They do not, for instance, include the urban real estate obligations held by trust institutions as trustees. A conservative figure would certainly show billions

TABLE LVI

URBAN REAL ESTATE DEBT OUTSTANDING IN THE UNITED STATES, 1932

(000,000 omitted)

Source of Funds	1932
Building and Loan Association[a]	$ 7,745
Life Insurance Companies[b]	5,708
Mutual Savings Banks[c]	5,884
Other Banks[c]	3,550
National Banks as Trustee[c]	672
Real Estate Bonds[d]	5,000
Title and Mortgage Guarantee Companies[e]	462
Total	$29,021

[a] United States Building and Loan League.

[b] Calculated from *Proceedings of the Twenty-Seventh Annual Convention of the Association of Life Insurance Presidents*, New York, (1933).

[c] *Annual Report of the Comptroller of the Currency*, 1932.

[d] See Annual *Proceedings of the Investment Bankers Association.*

[e] Clark, Evans, *The Internal Debts of the United States*, (1933).

of such investments in the personal trust department of these institutions. Individuals as trustee likewise administer huge sums and are undoubtedly large holders of such investments. Further, the data do not include the urban real estate obligations in the portfolios of many other types of institutions, and individual investors. If these additional holdings were added to those listed in Table LVI the writer believes the aggregate would exceed $40 billion for the years 1929-1933.

URBAN REAL ESTATE DEBTS, VALUE OF URBAN REAL ESTATE AND RENTS.—The significant thing about debts is not altogether their size, but rather their relation to the assets and income of the debtors who created the debts. These relationships are shown, in so far as the data permit, in Table LVII.

TABLE LVII

URBAN REAL ESTATE DEBTS, VALUE OF URBAN REAL ESTATE AND RENTS, 1913-1932

(000,000 omitted)

Year	Urban Real Estate Debts[a]	Value of Urban Real Estate[b]		Residential Rents[c]
		Profit Bearing	Total	(1913=100)
1913	$ 5,170	$16,500	$ 48,700	100
1921	9,100	36,600	79,100	159
1929	27,980	86,300	157,000	154
1932	29,021	43,100	78,500	127

[a] See Table LVI for references. Figures for 1913, 1921 and 1929 estimated by the writer.

[b] Doane, Robert R., *Measurement of American Wealth*, (1933), pp. 11, 15. The difference between profit bearing and total represents non-profit bearing urban real estate.

[c] United States Bureau of Labor Statistics.

The value and stability of urban real estate obligations are dependent upon the value and income of the underlying realty. The real estate must earn sufficient gross revenue to cover operation, maintenance, taxes, interest, and amortization. The ability to do this is predicated upon business conditions, for income and the number of vacancies are closely related to business activity. If business is poor incomes of all kinds are reduced and vacancies multiply. In consequence earnings of realty go down. Since 1929 our national income has been reduced about 40 per cent; rents have been drastically reduced; vacancies have greatly increased; and the value of urban real estate has shown a large decrease. While the trend of these factors was adverse to real estate the urban real estate debt has not changed appreciably in amount. Thus, there has been a substantial weakening of the underpinning of real estate obligations.[7]

COSTS OF OPERATING REAL ESTATE PROPERTY.[8]—We do not have satisfactory data regarding the costs of operating the property which secure real estate obligations. These costs are comprised of maintenance, wages, interest, amortization, and taxes. It has been estimated that wages comprise roughly 35 per cent of the total revenue; interest and amortization take about 30 per cent; taxes receive 25 per cent; and maintenance receives 10 per cent.[9] In general, the available data do not show any appreciable reduction in the costs of operating real estate. Interest charges and amortization are relatively fixed charges that remain practically as heavy as they were in 1929. Taxes are also a fixed charge and have not been appreciably reduced.[10] Maintenance and wages have come down, but not sufficiently to make up the loss in income.

THE BREAKDOWN OF REAL ESTATE OBLIGATIONS.—Business conditions broke down real estate values to a lower level each year from 1929 to 1933. In consequence there has been a general collapse in the whole real estate field. Although there are no definite data on the question of real estate defaults and foreclosures as a total, "it is estimated that approximately 60% of the outstanding real estate bond issues are more or less in distress."[11] "In the Chicago area there are thousands of real estate

[7] Investment Bankers Association, Report of Real Estate Securities Committee, 1931, p. 130.

[8] See Investment Bankers Association, Report of Real Estate Securities Committee, various years.

[9] Clark, Evans, *The Internal Debts of the United States,* (1933), p. 84.

[10] Rightor, C. E., "Tax Burden Lightens," *National Municipal Review,* Dec., 1932.

[11] Investment Bankers Association, Report of Real Estate Securities Committee, 1931, p. 130.

bond issues in foreclosure aggregating approximately one billion dollars."[12]

A survey made by the Federal Home Loan Bank Board of 123 savings banks and sixty-three insurance companies showed the following results relative to mortgages in arrears on interest payments as of January 1, 1933.

	Urban Home Mortgages	Apartment Building Mortgages
Savings Banks	12.1%	22.2%
Insurance Companies	13.8	28.5

These figures take on added significance when we consider the volume of urban home mortgages in the United States. The Federal Home Loan Bank Board estimated this volume at $21,450,000 in 1932. If we allow an average rate of delinquency on home mortgages of 15 per cent to 20 per cent of all outstanding mortgages there were roughly $3,000,000,000 or $4,000,000,000 worth of home mortgages in arrears at that time. If these conditions prevail throughout the field of urban real estate obligations, and the specific data from many sources warrant such an assumption, the investors in these obligations have incurred severe losses or their portfolios have greatly depreciated.

RULES OF LIFE INSURANCE COMPANIES.—The drastic changes that have taken place in the status of real estate loans have led life insurance companies to adopt certain guiding principles in the making of such investments, which may be summarized thus:

1. Preference in lending to home owners and resident managers of apartments, well located and of standard construction.
2. Closer limits regarding locations and neighborhoods.
3. More inquiry into moral risks involved—personal and business reputations of borrowers will be considered.
4. General revision of valuations, partly because of lower costs of building materials, and because of rent recessions in some classes of property.
5. More inquiry into structural character of buildings.
6. Insistence on prompt tax payments.
7. Insistence upon reduction of principal of loans, preferably monthly, but at least semi-annually. Not absurdly heavy amortization, but reasonable and regular payments.
8. Constant supervision of payment of interest, principal, taxes, and insurance.

[12] *Ibid.*, 1932, p. 118.

LEGAL SAFEGUARDS.[13]—Legal safeguards about mortgage loans intended for the investment of trust assets vary widely among different states. Just a brief note of the statutes of a few states on this subject reveals interesting situations. Some states have weak standards or none while others have taken steps to improve the quality of real estate obligations selected for trusts. If there are limitations laid down, from 50 to 60 per cent of the value of the property is the common standard. Forty per cent may be the standard under certain conditions.

Maine sanctions investment in "guaranteed" mortgages and mortgage bond issues of strong companies, but forbids mortgage loans to churches, factories, garages, clubs, hotels, theaters, and other special purpose real estate. Vermont permits mortgage loans on quarries, timberland, and industrial plants within specified limits. Savings banks in Rhode Island and New Hampshire must revalue all their mortgage loans at least every five years; if the property falls below 70 per cent of the former appraisal they must reduce the loan. Real estate obligations, other than first mortgages, are approved investment for trust assets in New Jersey and Minnesota. Only a small number of states have specified the ability to pay interest as a requirement for such loans.

Florida provides that at no time shall more than 40 per cent of trust assets be invested in mortgages, and the loan must not exceed 50 per cent of the actual value of the propery. Tennessee requires appraisals of properties to be made by licensed real estate appraisers or qualified officers of the trust institution. In Texas, in order for a loan to be legal for trust assets an attorney must pass upon all the papers. Such loans are proper in West Virginia provided they do not exceed 80 per cent of the assessed value of the property. Oregon has recently provided that no loan on real estate, plus taxes not due and bonded indebtedness for public improvements not due, shall exceed 50 per cent of the actual cash market value of the property. Illinois and South Carolina permit the investment of trust assets in mortgages in any state of the Union.

In view of the existing conditions in the real estate obligation field there is a real need for greater care in the selection and administration of real estate loans for trust funds. It is important that more adequate and intelligent safeguards be laid down regarding the selection of such investments. A discussion of these factors, however, is beyond the scope of this book.

[13] Reilly, E. J., "Real Estate Obligations as Legal Investments for Trust Funds," *Trust Companies,* Vol. 54 (April 1932), p. 473.

Chapter XVII

TRUST INVESTMENTS IN THE CORPORATE FIELD—RAILROADS

TO judge by the percentage held in the 196 trusts, corporate securities compose the major proportion of trust investment. The extent to which trust investments depend upon corporate enterprises is shown in Table LVIII.

TABLE LVIII

THE PROPORTION OF THE TRUST PRINCIPAL OF 196 TRUSTS INVESTED IN CORPORATE ENTERPRISES, 1919-1932

Year	Per cent	Year	Per cent
1919	56.4	1926	51.9
1920	55.2	1927	52.2
1921	54.7	1928	53.0
1922	55.2	1929	55.2
1923	55.8	1930	54.9
1924	55.6	1931	53.8
1925	53.7	1932	53.4

Over one-half of the trust principal was invested in the corporate field. The average was 54.4 per cent for the fourteen years. The percentage in railroad securities was reduced nearly two-thirds; the total in utilities showed a slight increase; the proportion in industrial obligations was substantially increased; and the amount in bank and finance securities remained about the same.

The proportion of the trust property invested in the industrial field was nearly as great as the combined total of railroad and public utility securities, taking the average for the fourteen years. For each year, 1929 to 1932, industrial securities comprised over 50 per cent of the aggregate investment in corporate enterprises.

Stocks comprised 73 per cent of the total investment in corporate enterprises, common stocks alone amounting to 61 per cent. Industrial common stocks as an average for the fourteen years composed 33 per cent of the aggregate corporate investment.

RAILROAD SECURITIES

RAILROAD OBLIGATIONS IN TRUST PORTFOLIOS.—Trust institutions today are particularly interested in the railroad field because a significant portion of their trust assets are invested in railroad obligations. Although the proportion of investment in this class of securities has been steadily declining in recent years, according to the data of 196 trusts, the amount so invested is still large. No accurate figures are available for trust institutions as a whole, but some idea of the extent of rail securities held by them may be gained from our data on the holdings of trust institutions in five leading cities. These data are set forth in Table LIX.

TABLE LIX

THE PROPORTION OF THE PRINCIPAL OF 196 TRUSTS INVESTED IN RAILROAD SECURITIES, 1919-1932

Year	Bonds	Preferred Stock	Common Stock	Total
1919	9.1%	2.7%	10.1%	21.9%
1920	8.8	2.6	9.9	21.3
1921	8.4	2.6	8.5	19.5
1922	8.5	2.4	7.8	18.7
1923	8.0	2.3	7.2	17.5
1924	8.2	2.2	6.8	17.2
1925	8.0	2.1	6.7	16.8
1926	8.0	2.1	6.4	16.5
1927	8.1	1.8	6.4	16.3
1928	7.6	1.4	4.8	13.8
1929	6.0	1.3	2.7	10.0
1930	5.6	1.3	2.5	9.4
1931	5.4	0.7	1.8	7.9
1932	5.1	0.7	1.7	7.5

Railroad bonds have long been regarded as among the prime investments for trustees. Trust literature is replete with praise for them. Recently it was advocated that underlying railroad bonds might well comprise 20 per cent of the principal of a trust. In view of these ideas what has been the practice of trust institutions with regard to investing in railroad securities?

POLICY OF TRUST INSTITUTIONS.—In the 196 trusts as a composite the investment in rails increased during the period from the inventory to 1919. The increase was primarily in railroad bonds. Throughout the period 1919 to 1932 the trust institutions followed the policy of decreasing the proportion in railroad obligations, both bonds and stocks. Thus, from 1919 to 1932 there was a decrease from 21.9 per cent to 7.5 per cent. Even the proportion in bonds was reduced nearly one-half.

Although the percentage allocated to rails was drastically reduced, the number of trusts holding these securities at the end compared with the beginning showed a substantial increase. Of the 196 trusts, seventy-two held railroad bonds in the inventory and ninety-four at the end. The tendency was, however, that toward the end railroad securities comprised a smaller percentage of the trusts which held them.

Since railroad bonds are legal for trust investment in these five states, as well as in other states, the policy followed by the trust institutions was a voluntary one. It indicates that railroad obligations as a total were the least favored of any field, except finance. Even during the period of the twenties when railroads were showing substantial earnings the bond holdings were being reduced. Apparently the practice was merely to reduce the proportion of the principal in railroad securities irrespective of the trend in economic conditions.

POLICY OF LIFE INSURANCE COMPANIES.—Although the principal legal reserve life insurance companies have invested a larger percentage of their assets in railroad securities than is indicated for trust institutions, the percentage so invested has been constantly reduced. In 1906, 34.8 per cent of their assets were invested in railroad bonds and stocks; in 1921, the proportion was 22.9 per cent; in 1929 it was 17.7 per cent; and in 1932 it amounted to 15.6 per cent.[1] Of the new investments made during 1930, 10 per cent were in railroad bonds and stocks; in 1931, 10.4 per cent; and in 1932, 1 per cent.

To gain some conception of the problems confronting trust institutions in the railroad field, we must study the trend of rail earnings and appraise in some measure the general factors affecting railroad credit.

RAILROAD INVESTMENT, CAPITALIZATION AND BORROWED FUNDS.—In Table LX, on page 243, is shown the total property investment of all railways, total railway capitalization, and total funded debt.

Through the period covering the major development of our railroads the principal part of railway capital has been supplied by the bond buyer. This practice has resulted in the capital structure of the railway system being made up predominately of funded debt. The ratio of funded debt to total capitalization has not been below 50 per cent since 1900. It has not been under 55 per cent since 1910 and from 1920 to 1932 it has consistently exceeded 58 per cent.

[1] *Proceedings of the Twenty-Sixth Annual Convention of the Association of Life Insurance Presidents,* (1932), p. 108.

TABLE LX

RAILWAY PROPERTY INVESTMENT, CAPITALIZATION, AND DEBT, 1910-1932[a]

(000,000 omitted)

	1910	1916	1921	1926	1929	1932
Railway Investment...	$14,558	$17,843	$20,329	$23,881	$25,465	$26,087
Total Capitalization[b]...	18,417	21,049	22,292	23,677	23,983	24,837
Total Funded Debt Outstanding	10,303	12,000	13,216	14,192	14,065	14,723
Ratio to Total Capitalization	56.0	57.0	59.2	59.8	58.6	59.3
Net Capitalization[c]....	14,376	16,333	17,083	18,234	18,680	18,894
Net Funded Debt	8,817	9,917	10,409	11,404	11,467	11,836
Ratio to Net Capitalization	61.3	60.7	60.9	62.5	61.4	62.6

[a] Interstate Commerce Commission, *Statistics of Railways in the United States*. All roads. Data for 1910 ended June 30.
[b] Securities actually outstanding, "nominally issued," and "nominally outstanding."
[c] Total outstanding securities exclusive of those held by railways.

During the decade from 1900 to 1910 railway common stocks had risen to a stronger position than they had previously held and in consequence additional issues were floated aggregating $2,200,000,000, an increase of about 48 per cent during the decade. During the whole period from 1910 to 1932 common stocks increased only $1,300,000,000, or less than 20 per cent. On the other hand funded debt not only doubled in the decade 1900 to 1910, but it also continued to increase through the subsequent period, rising nearly 40 per cent from 1910 to 1932.

In the twelve year period 1920-1931, Class I railways issued new securities aggregating $10,102,000,000. Of this total $7,859,000,000, or 77.8 per cent, represented funded debt and $2,243,000,000 or 22.2 per cent, represented stock. The proportion in stock varied from 4 per cent in 1920 to 33.6 per cent in 1927.

During the period 1920-1932 there was an increase in the total capitalization of railways of nearly $2,500,000,000. In the same period the railroads added about $6,000,000,000, or approximately 30 per cent, to their investment in physical assets.

This trend of development is a significant feature of railway finance. Undoubtedly it reflects the relative unattractiveness of railroad common stocks as contrasted with this type of investment in other fields. Further, it has resulted in a disproportionately large funded debt, entailing a burden of interest charges of nearly $600,000,000 annually in recent years. To realize the full import of these trends we should observe other factors in the railroad situation.

TREND IN TRAFFIC.—There was an increase of nearly 86 per cent in revenue ton-miles in the decade 1890-1900. From 1900 to 1910 the increase was 80 per cent; from 1910 to 1920, 62 per cent; and from 1920 to 1929 the increase was only 9 per cent. Each decade from 1890 showed a smaller percentage growth, compared with the preceding one, in revenue ton-miles of freight.

Passenger miles increased 35 per cent in the period 1890 to 1900; 102 per cent for the years 1900 to 1910; 47 per cent from 1910 to 1920; from 1920 to 1929 there was a decrease of 34 per cent. Passenger miles showed a large increase until 1910 but thereafter a heavy decrease.

Railway traffic statistics for various years, 1911 to 1933, are shown in Table LXI.

TABLE LXI

RAILWAY TRAFFIC STATISTICS, 1911-1933[a]

Year	Revenue Carloadings (000 omitted)	Revenue Ton-miles (000,000 omitted)	Revenue Passenger-miles (000,000 omitted)
1911	.....	249,843	32,371
1916	.....	362,444	34,586
1920	45,118	410,306	46,849
1925	51,224	413,814	35,950
1929	52,828	447,322	31,074
1931	37,151	309,225	21,894
1933	28,961	249,779	16,345

[a] Interstate Commerce Commission. Class I railways.

There was only a small increase in railway traffic during the decade of the twenties. In the period 1920-1929 revenue ton-miles increased only 8 per cent over the preceding ten years while revenue passenger-miles decreased 34.2 per cent. Carloading in 1933 decreased 44.4 per cent below the five-year average, 1925-1929. The 1933 figure, however, represented a gain of 2.8 per cent over 1932. Revenue ton-miles in 1933 decreased 42.4 per cent compared with the five-year average, 1925-1929, but gained 6.8 per cent over 1932. Passenger-miles in 1933 dropped 51.3 per cent below the five-year average of 1925-1929 and 3.7 per cent below 1932.

The traffic statistics confirm certain broad facts which are generally well understood. The freight movement was comparatively high in the period 1916-1920, reaching a peak in 1920. After the severe reactions in 1921 and the 1922 strikes it rose rapidly with the boom in general business. The peak reached in the forepart of 1923 was exceeded only by those of late 1926

and early 1929. The recessions in basic industry in 1923-1924 and in 1927 brought a severe contraction in freight traffic in 1924 and in 1927 but that in the latter year was far less noticeable.

The freight movement after the 1929 boom steadily declined until the middle of 1932. There was no substantial tendency toward stabilization or actual improvement until the summer of 1932. There was a moderate recovery in freight traffic during the second half of 1932 but those gains were quickly lost in the first quarter of 1933. With the revival in general business in mid-March, 1933, the freight traffic record has been distinctly better, showing a substantial gain for the year ending in the first quarter of 1934. Undoubtedly freight traffic will show a vigorous recovery in 1934 if general business maintains its improvement.

REVENUE PER TRAFFIC UNIT.—Changes in railway rates naturally affect the course of railway earnings. The figures for freight revenue per ton-mile, and passenger revenue per passenger-mile are set forth in Table LXII.

TABLE LXII

AVERAGE REVENUE PER TON-MILE AND PASSENGER-MILE, 1911-1933[a]

Year	Revenue per Ton-mile (cents)	Revenue per Passenger-mile (cents)
1911	0.743	1.964
1919	0.987	2.548
1921	1.275	3.086
1923	1.116	3.018
1925	1.097	2.938
1927	1.080	2.896
1929	1.076	2.808
1931	1.051	2.513
1933	0.997	2.013

[a] Interstate Commerce Commission.

There has been a constant reduction in revenue per traffic unit since 1921. The reduction for the twelve year period was 21.8 per cent in average revenue per freight ton-mile, and 34.8 per cent in average revenue per passenger-mile.

A portion of the decline shown in Table LXII with reference to freight rates is the result of a change in the character of the traffic carried. The decline in average revenue per passenger-mile is due in part to the relatively increasing percentage of commutation traffic.

RAILWAY EARNINGS.—The financial results of railroad opera-

tion for the various years from 1910 to 1932 are shown in Table LXIII.

TABLE LXIII

FINANCIAL RESULTS OF RAILWAY OPERATION, 1910-1932[a]

Year	Total Operating Revenues (000,000 omitted)	Net Railway Operating Income (000,000 omitted)	Gross Income (000,000 omitted)	Fixed Charges (000,000 omitted)	Times Fixed Charges Earned	Dividends—Per cent on all Stocks Outstanding
1910	$2,751	$ 928	$1,180	$ 511	2.30	5.00
1916	3,597	1,040	1,253	623	2.01	4.19
1921	5,517	601	976	662	1.47	5.13
1926	6,383	1,213	1,511	702	2.15	5.06
1929	6,280	1,252	1,612	715	2.25	5.70
1931	4,188	526	832	696	1.19	4.01
1932	3,127	326	551	690	0.80	1.50

[a] Interstate Commerce Commission. Class I railways.

Railway revenues fluctuated violently in the post war period, 1919-1921, due to business irregularities, strikes and rate changes. Although gross revenue was high in 1920, net was at an exceedingly low level. The year 1921 marks the period in which a considerable advance was made in railway efficiency. Although it was a year of severe business depression, there were many favorable factors such as weather conditions, reduced prices and the reduced burden upon the roads. Much was done to restore railway efficiency and to place the roads in a position to enjoy the advantages of the subsequent revival in general business.

During the period 1923-1929 general business enjoyed almost continuous prosperity. At the same time the railway business was at a high level, total operating revenues averaging over $6,000,000,000 yearly. Railroad net income averaged approximately $1,100,000,000 during the same years. In the years 1923-1929 gross revenues remained practically constant but the trend of net was slightly up. The improvement in net was primarily due to the progressive increase in railway operating efficiency. There were no exceptional savings in maintenance so the reduction in expenses was made in the item labeled "transportation expenses." During the same period rates and fares were being reduced, as noted in Table LXII.

From mid-1929 railway earnings were irregularly downward until about March 1933. There was considerable revival in both gross and net in the latter part of 1932 but it was not sustained. Receding again, earnings reached early in 1933 the lowest point in the depression. Since then there has been substantial revival.

Operating revenues of Class I railroads totaled $3,095,000,000 in 1933, compared with $3,127,000,000 in 1932, a decrease of 1 per cent. Revenues last year were 50.8 per cent below the 1929 level and operating expenses were 50.1 per cent below. Net railway operating income in 1932 was 74 per cent under 1929. The 1933 figure was increased to the 1931 level, or a gain of 31.3 per cent over 1932. Railroad earnings continued to make substantial progress through the first quarter of 1934. The revival in earning power will not wane unless business recedes.

Although the total income of railways increased during the period 1922-1929, the actual improvement was not great because fixed charges also mounted. During these years interest accrued on funded debt increased over $50,000,000 and taxes rose over $90,000,000. After payment of fixed charges there was a net deficit from Class I railway operations in 1931, 1932, and 1933.

RETURN ON INVESTMENT.—Table LXIV compares the rate of return earned by Class I railways on their property investment from 1911 to 1933.

TABLE LXIV

RATE OF RETURN ON PROPERTY INVESTMENT, CLASS I RAILWAYS, 1911-1933[a]

Year	Per cent	Year	Per cent
1911	4.84	1929	4.84
1916	5.90	1931	2.00
1921	2.87	1932	1.25
1923	4.33	1933	1.80
1926	4.99		

[a] Interstate Commerce Commission.

At no time since the transportation act of 1920 have the railways earned their so-called "fair return" of 5¾ per cent. Such figures, however, should be used with caution for they strike an average between all roads, the weak as well as the strong. There are a number of good roads which have earned a comparatively high rate of return on their property investment.

THE EMERGENCY IN RAILWAY FINANCE.—In the period 1920-1929 the gross operating revenues of Class I railways showed no noticeable tendency to expand. During the same period the railways added about $6,000,000 to their property investment, which increased the efficiency of operation and lowered costs. At the same time, however, rate reductions virtually nullified the possible increase in net earning power. During these same years total railway capitalization had been expanded and funded debt was increased by more than $1,000,000,000.

In face of these facts the decline in operating revenues to a low level for four years has placed the railways in a sad plight. Of the 167 Class I railroads, seventy-five failed to cover their fixed charges in 1931. That is, these roads not only had nothing left for stockholders, but in order to pay their bonded interest and guaranteed lease rentals they had to draw upon their cash balances or else borrow from the banks. In 1932 at least 112 Class I roads failed to cover their fixed charges; fifty-nine showed operating deficits, that is, they did not earn their operating expenses and taxes. The net deficit after fixed charges amounted to $152,135,000 in 1932 and to $13,801,000 in 1933.[2]

Thirty railway issues defaulted in 1931, with a total par value of $213,000,000. In 1932, thirty-seven issues defaulted with a total value of $202,000,000. The number of issues and the aggregate amount of defaults greatly increased in 1933. It is believed that fully $3,000,000,000 to $4,000,000,000 of railroad bonds were in default during 1933, or default was averted only through assistance received from such governmental sources as the Railroad Credit Corporation, the Reconstruction Finance Corporation, and from the workings of a liberalized bankruptcy act.[3]

Reflecting the depressed state of the railways we find that, during 1931, forty-five roads representing about 5 per cent of the total mileage, were in receivership. At the end of 1933 there were twenty-five Class I railways in receiverships, or which had filed application for reorganization, with a total of 40,064 miles of line.[4]

RAILROAD SECURITIES.—In the face of a poor showing over a prolonged period it is small wonder that the railways have been unable to keep up their interest and dividend payments. During the years 1931, 1932, and 1933 there was a wholesale omission of dividends. In consequence, railway securities have fallen to almost unprecedented low levels. According to Dow-Jones Company the prices of the stocks of twenty of our principal railroads in 1933 were far below their low price in 1897. As of March 1, 1933, 652 railroad bonds listed on the New York Stock Exchange with a par value of $10,534,000,000 were currently quoted at $5,762,000,000. This represents a depreciation of 45 per cent below par.[5] Junior issues had depreciated over 60 per cent in

[2] Interstate Commerce Commission.

[3] Clark, Evans, *The Internal Debts of the United States*, (1933), p. 132; Bureau of Railway Economics, *A Review of Railway Operations in 1933*, p. 4 ff.

[4] *Supra*, n. 2; Bureau of Railway Economics, *op. cit.*, p. 7.

[5] *New York Stock Exchange Bulletin*, Vol. IV, No. 3 (March 1933), pp. 8-9. Percentage depreciation of railway bonds was more than twice that for all American listed bonds as of the same date.

1932 while the better grade issues had dropped only about 25 per cent.[6]

A large percentage of the defaulted railway bonds have been junior issues. Comparatively few of the underlying lien issues have defaulted.

MEETING THE RAILROAD EMERGENCY.—The ability of many roads to survive at all is open to question. That they are in a pitiable plight is evidenced in abundance by recent events such as decreased earnings, defaults, and receiverships. With the hope of rehabilitating railway credit a number of measures have been adopted such as several states granting a moratorium on their "legal" rail list as many of these issues were unable to meet the requirements laid down for legality; the authorization of temporary freight rate increases, such funds to be handled by the Railroad Credit Corporation as a loan fund; a reduction in wages of railroad workers; granting direct financial aid to many roads by the Reconstruction Finance Corporation; the creating of the National Transporation Committee to study the railroad problem; the Bankruptcy Act of 1933; and finally the Emergency Railroad Transportation Act.

It is too early to predict the results of the attempts to relieve the railroad problems. In the meantime, the status of railroad obligations, except the better underlying lien bonds, as trust investments will remain in doubt.

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[6] See the chart of bond prices published weekly by the *New York Herald Tribune.*

Chapter XVIII

TRUST INVESTMENTS IN THE CORPORATE FIELD—PUBLIC UTILITIES

PUBLIC utility securities, practically unheard of twenty years ago as investment media for trusts, now occupy a prominent place among the lists of approved investments in nearly all the states. The extent of their growing popularity is attested by the fact that the proportion they compose of the total investment of trust institutions and life insurance companies has been steadily increasing.

TRUST INSTITUTION INVESTMENT IN UTILITIES.—There are no satisfactory data showing the volume of trust assets invested in the public utility field. Data, however, from nineteen large trust institutions in five states afford an excellent sample. Table LXV shows the relative proportion of the trust principal of 196 trusts invested in public utility securities for each year 1919 to 1932.

TABLE LXV

THE PROPORTION OF THE PRINCIPAL OF 196 TRUSTS INVESTED IN PUBLIC UTILITIES, 1919-1932

Year	Bonds	Preferred Stock	Common Stock	Total
Inventory	2.8%	0.8%	8.2%	11.8%
1919	2.8	0.7	8.1	11.6
1920	2.8	0.7	7.9	11.4
1921	2.9	0.7	7.0	10.6
1922	3.2	0.7	5.9	9.8
1923	3.5	0.8	5.4	9.7
1924	4.2	0.8	5.3	10.3
1925	4.3	0.9	4.2	9.4
1926	4.3	0.9	3.8	9.0
1927	4.6	0.7	3.6	8.9
1928	5.1	0.8	3.8	9.7
1929	6.9	0.9	3.7	11.5
1930	7.5	1.1	3.2	11.8
1931	7.9	0.6	3.4	11.9
1932	8.6	0.7	3.2	12.5

POLICY OF TRUST INSTITUTIONS.—Literature in the trust field has been most favorable toward utility securities, especially utility

bonds. It has been suggested that such bonds might well comprise 30 per cent of a large trust account.[1] The data of 196 trusts do not show that utility obligations were so favored by trust institutions. In fact the composite investment of the 196 trusts averaged only 10.6 per cent in utilities for the fourteen years, 1919-1932. The proportion was constantly decreased from the inventory period to 1927 when the total fell to 8.9 per cent. From 1927 to 1932 there was a constant increase in this investment, a high of 12.5 per cent being reached in the latter year. The decrease and rise in the total percentage of utilities are due to the trends of investment in utility bonds and utility common stocks. The bonds showed a substantial increase throughout the period studied while common stocks were materially reduced.

In the various cities there were wide differences regarding investment in utilities. The Boston trusts contained the largest proportion in this field, holding nearly 40 per cent of the aggregate investment in these securities in 1932. New York held the smallest percentage in utilities of any city. There the proportion was reduced from 5.5 per cent in 1919 to 2.3 per cent in 1928. From 1928 to 1932 there was a gain, the investment rising to over 4 per cent in 1932. The situation in New York is partially explained by the fact that utility bonds were not authorized investments for trustees until 1928. The Chicago trusts substantially increased the percentage in utility bonds but reduced the holdings in utility common stocks. Cleveland trusts held only a small percentage in utility bonds. The holdings in utility common stock were not large in 1919, but even so, they were reduced. St. Louis trusts increased the proportion in both utility bonds and common stock, although the aggregate so invested was relatively small.

It is interesting to note that the trusts less than $500,000 in size carried fully as large a percentage of their investment in utilities as did the trusts of $500,000 or larger.

The number of individual trusts holding utility bonds rose from fifty-two in the inventory to eighty-eight in the last year for which data were collected. The number investing in utility preferred stocks also increased, rising from forty-three in the inventory to sixty-one in the last year. The number of holding common stocks decreased by five. Not only did a larger number of trusts select utility bonds in the end period as compared with the inventory but the tendency was also clearly evident that in-

[1] Evans, Arthur H., "Trust Investments and Policies," *Proceedings Eleventh Pacific Coast and Rocky Mountain Trust Conference,* Oct. 26-27, 1933, p. 67.

dividual trusts invested a larger percentage of the principal in these obligations, as shown in Table XXVII on page 184.

POLICY OF LIFE INSURANCE COMPANIES.—The proportion of the investment of fifty-two legal reserve life insurance companies in public utility securities (almost entirely in bonds) was reduced from 4.7 per cent in 1906 to 3 per cent in 1921. From 1921 to 1932 the percentage so invested was increased, becoming 9.6 in the latter year. This does not indicate a pronounced favoring of utility investments. Of the new investments made during 1930, 15.9 per cent were in public utility bonds and stocks. In 1931 the proportion was 21.4 per cent; in 1932 it was only 10.1 per cent.

THE PUBLIC UTILITY FIELD.—Public utility investments comprise a multitude of securities, bonds and stocks of numerous kinds, representing electric light and power, electric railway, telephone, telegraph, gas, and water companies. Although the public utility industry is comparatively new it has grown tremendously during recent years, in sharp contrast to the almost static condition of the railroads. The development of utilities has been attendant upon the growth of urban population, which has increased at an accelerated pace. In consequence the utility industry developed to supply the needs of these people and the businesses of these areas until today it occupies a significant place in our industrial and social life.

The electric light and power industry has grown more rapidly than any other utility group. The telephone group has developed second most rapidly. The electric railways, however, have declined. Even prior to the depression they had declined substantially from their pre-war peak.

The favorable showing of utilities for more than a decade has made the utility industry a favorable field in which to invest capital. In general, the risk has been comparatively low, therefore the price paid for capital has not been high. Today utilities can probably secure capital at a lower price than can any other industry.[2] Of course the situation has been perturbed during recent years due to the demoralization of the securities market and business in general. Not all phases of the utility industry have shown substantial progress, as for example the electric railways. Hence, the electric railways have not been able to secure capital so favorably.

UTILITY SERVICES.—The development of utility services is set forth in Table LXVI.

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[2] Moody's *Public Utilities* give ample data on this point.

TABLE LXVI

DEVELOPMENT OF PUBLIC UTILITY SERVICES, 1912-1932[a]
(Thousands)

	1932	1927	1922	1912
Kilowatt-hours Generated	79,657,467	74,687,000	40,292,000	11,569,000
Number of Electric Light and Power Customers	23,862	21,786	12,710	3,838
Number of Telephones	17,424	18,523	14,347	8,730
Revenue Car-miles	1,690,000	2,163,773	2,124,523	1,921,620
Cubic Feet of Gas Sold[b]	1,890,208,000	....	....	....

[a] Bureau of the Census.
[b] Data on natural gas from Bureau of Mines; for manufactured gas, from American Gas Association.

These are significant growth data which give a cross section of the industry at various periods. The percentage changes during the period will show the striking growth of the different groups. Kilowatt-hours generated in 1932 show nearly a 600 per cent increase over 1912 and almost a 100 per cent gain over 1922. The number of electric light and power customers show a similar increase for the same periods. The increase in the number of telephones is not so pronounced. From 1912 to 1932 there was an increase of about 100 per cent, but from 1922 to 1932 the gain was only about 22 per cent. On the other hand the revenue car-miles showed a decrease in 1932 compared to 1912. Very little increase has been shown in the electric railway industry since 1922. All the utility services show a decrease in 1932 compared to the peak of services in the nineteen twenties. But the decrease has not been so pronounced as in the industrial or railroad field. In truth the utility services have held up better than any other major field.

PLANT INVESTMENT AND CAPITALIZATION.—The plant investment and capitalization for the different utility groups, as of December 31, 1932, is set forth in Table LXVII, on page 254.

The total value of plant and equipment of all utilities in 1902 was $3,364,000,000, in 1912 it was $8,194,000,000 and in 1922 it was $11,980,000,000. From 1922 to 1932 the capital investment was increased by about $14,000,000,000, or approximately 123 per cent.

The capital invested in the electric light and power industry has shown a more pronounced growth than in any utility group. It increased from $505,000,000 in 1902 to $2,176,000,000 in 1912,

TABLE LXVII

PUBLIC UTILITY INVESTMENT AND CAPITALIZATION, 1932[a]

(000,000 omitted)

Utility Group	Plant Investment	Capitalization: Funded Debt	Preferred Stock	Common Stock	Total
Electric Light and Power	$12,664	$ 5,886	$2,299	$3,596	$11,781
Telephone	4,792 }	1,464	294	2,849	4,607
Telegraph	506 }				
Electric Railways	4,000	1,983	301	1,800	4,084
Gas	3,000	1,025	306	1,390	2,721
Water	750	505	89	238	732
Total	$25,712	$10,863	$3,289	$9,873	$23,925

[a] Bureau of Foreign and Domestic Commerce, *National Income, 1929-32;* Bureau of the Census, *Census of Electrical Industries:* 1932; *Statistical Abstract of the United States, 1933;* Interstate Commerce Commission, *Statistics of Railways,* 1933; publications and data from Edison Electric Institute, Transit Association, American Gas Association, American Water Works Association, American Telephone and Telegraph Company, Commercial and Financial Chronicle. Capitalization figures, except for electric light and power, are for 1931.

and to $4,465,000,000 in 1922. The decade 1923-1932 saw a further growth of $8,200,000,000 in this industry, making the aggregate $12,664,000,000. This group comprises about 50 per cent of the total utility industry as shown in Table LXVII. In 1902 it was less than 15 per cent of the total but by 1912 it had grown to 27 per cent of the aggregate. The telephone industry also grew rapidly, rising from a capital investment of $389,000,000 in 1902, to $1,081,000,000 in 1912, and to $2,130,000,000 in 1922. From 1922 to 1932 the plant investment was more than doubled. The electric railways increased their investment from $2,308,000,000 in 1902 to $4,715,000,000 in 1912 and to $5,058,000,000 in 1922. Since that time retrogression has marked this industry. The telegraph and cable group has shown a steady but very moderate growth.

In general, capitalization in the public utility industries has been considered fairly conservative, or well within property values. This also holds true for the relation of long-term debts to total plant investment or capitalization. In 1931-1932 total capitalization amounted to 93 per cent of the plant investment. Funded debt comprised 46 per cent of the total capitalization.

For the electric light and power industry total capitalization was 93 per cent of plant investment as of 1932. Funded debt comprised 50 per cent of total capitalization. Telephone companies

had the smallest funded debt relative to capitalization and electric railways had the highest. The capitalization of the telephone industry was about 80 per cent of plant investment while the capitalization of the electric railways was 102 per cent.

In a group of electric light, gas, and telephone and telegraph industries comprising thirty-one companies,[3] having a total invested capital of $14,736,000,000, capitalization, including funded and long-term debt, preferred stock, and common stock and surplus, amounted to $14,493,000,000 or 98.3 per cent. Funded debt comprised 57.4 per cent of total capitalization. In the group there were ten operating companies with an invested capital of $3,730,000,000 and a capitalization of $3,597,000,000. Funded debt amounted to $1,621,000,000, or 45.1 per cent of total capitalization. For the sixteen holding companies, having an invested capital of $9,535,000,000 funded debt comprised $6,158,-000,000, or 65.2 per cent of a capitalization aggregating $9,439,000,000.

In the Bell Telephone System the telephone plant amounts to $4,189,000,000 and capitalization equals $3,155,000,000 as of December 31, 1932. Funded debt comprised 33.1 per cent of total capitalization.[4]

It should be noted that individual companies show wide differences in the pattern of their capital structure.

TRENDS IN FINANCING.—Public utility financing in the decade of 1920-1929 showed an aggregate of $18,161,000,000 which was divided among different types of securities as follows: Bonds, $10,305,000,000; notes, $1,172,000,000; and stocks, $6,684,000,-000.[5] Until about 1928 the general practice in the electric light and power industry was to finance properties primarily by first mortgage bonds. Due to the nature and stability of the industry properties were frequently mortgaged up to 70 or 75 per cent of their value. Initially the closed mortgage was used but this type of financing was ill-adopted to supply the needs of such an industry. The problem was largely solved in the employment of the open-end first and refunding mortgage bond. More recently a great deal of the capital acquired came from the sale of these bonds. As a means of financing this industry, debenture bonds and notes have also been fairly prominent, especially during the twenties. A goodly portion of the remaining capital for the electric light and power industry has been raised through the

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[3] Standard Statistics Company, Inc., *Standard Earnings Bulletin,* July 20, 1933, p. 4.

[4] American Telephone and Telegraph Company, *Annual Report,* 1932.

[5] Dow-Jones compilation.

sale of stock, primarily common stock. In the decade 1922-1932 preferred stock came into greater use.

With the growing demand for equity securities electric light and power companies turned primarily to stock financing in 1928-1929. For these years, the first time in the history of the industry, stocks accounted for over 50 per cent of the capital raised. Since the demoralization of the stock market in 1929, bonds have again been resorted to as the basic means of financing. Financing for the years 1929-1932 was as follows, in millions:[6]

	1929	1930	1931	1932
Mortgage Bonds	$ 216	$ 477	$ 786	$293
Debentures	292	378	135	30
Notes	15	260	163	79
Preferred Stock	286	179	92	47
Common Stock	506	159	166	...
Local Sales	153	139	150	18
Total	$1,469	$1,592	$1,492	$467

The telephone industry has been financed primarily through the sale of common stock or by plowing back earnings into the business.

At first the electric railways followed simple methods of finance. Their capital structure was composed largely of stock issues or of first mortgage bond issues. Later the consolidation of properties brought complications in finance. By 1912 funded debt comprised about 50 per cent of the total capitalization and by 1922 it had become 58 per cent. Since that date bonded indebtedness has increased to nearly 60 per cent. Even as early as 1912 a large proportion of the stocks in this industry were paying no dividends.

OPERATING REVENUES AND OPERATING RATIOS.[7]—Operating revenues of public utilities, except electric railways, have had an almost unbroken advance from year to year until the present economic disturbance. Gross operating revenues increased from about $1,200,000,000 in 1912 to $2,900,000,000 in 1922 and to over $4,500,000,000 in 1932. In the electric power and light industry gross operating revenues have moved almost continuously upward, rising from about $300,000,000 in 1912 to nearly $1,000,000,000 in 1922 and to a peak of $2,140,000,000 in 1931. There

[6] Compiled from *Electrical World.*

[7] Compiled from Bureau of the Census, *Census of Electrical Industries: 1902, 1912, 1922, 1932*; Interstate Commerce Commission; Edison Electric Institute; American Telephone and Telegraph Company; Transit Association; *Electrical World.*

was a slight recession in 1932 and 1933 but the trend is again upward. Even these years were considerably above 1927.

Operating revenues in the telephone industry have also increased rapidly, rising from about $90,000,000 in 1902 to $250,000,000 in 1912, to $666,000,000 in 1922, and to $1,062,000,000 in 1932. The peak was reached in 1930, a decrease occurring since that year and extending through 1931-1933. The trend is again upwar1, however. Revenues in 1932 were still 3.8 per cent above 1927. From 1922 to 1932 there was a 61.1 per cent increase.

Gross operating revenues of telegraph and cable systems increased from $41,000,000 in 1902 to $60,400,000 in 1912, to $147,000,000 in 1922, and to $178,000,000 in 1927. The maximum was reached in 1929 but since then there has been a sharp drop. Gross revenues were $115,000,000 in 1932, a decrease of 35.4 per cent from the 1927 figure.

Electric railway gross operating income rose from $250,000,000 in 1902 to $568,000,000 in 1912 and to $1,017,000,000 in 1922. After 1922 there was a decrease, the total being only $566,000,000 in 1932, 43.9 per cent below 1922.

Operating expenses have shown an upward trend similar to gross operating revenues. The percentage increase, however, was less in most groups and in consequence operating ratios were reduced, especially during the twenties. Operating expenses, excluding depreciation, taxes, and interest, in the electric light and power industries were 43.5 per cent of operating revenues in 1933. The electric railways had an operating ratio of 80.6 per cent. For more than a decade the ratio has been rising in this industry. The operating ratio of the Bell Telephone System has been remarkably constant. In 1932 it was 70.7 per cent, in 1922, 71 per cent and in 1917, 70 per cent. The operating ratio of telegraph and cable companies was about 90 per cent in 1932. It was 80 per cent or above for each year during the past decade.

NET EARNINGS AND INVESTED CAPITAL.[8]—Net earnings of public utilities have been substantial for at least the past two decades. During the period 1912 to 1932, the percentage earned on invested capital for all utilities has averaged yearly from slightly less than 5 per cent to over 6 per cent. From 1922 to 1931 the average was probably 6 per cent or better.

An analysis of the income data of thirty-one utility companies having an aggregate invested capital of approximately $15,000,000,000 showed earnings of 6.1 per cent on invested capital in 1931

[8] *Supra*, n. 7.

and 5.5 per cent in 1932.[9] These thirty-one companies represent a cross section of the utility industry and were composed of electric power, light, gas, telephone and telegraph enterprises and included both operating and holding companies.

The composite income account of twenty-two utility companies representing invested capital of $6,700,000,000 in 1927 and $9,200,000,000 in 1932 had average earnings of 6.6 per cent on total invested capital for the six years, 1927 to 1932. In 1931 it was 6.3 per cent and in 1932 it was 5.6 per cent.[10]

The telephone industry has had an enviable record. For the Bell Telephone System the percentage earned on plant investment has been at least 7 per cent as an average for the two decades 1912 to 1932. In only two years during that time, 1920 and 1932, has net earnings been less than 6 per cent on the book value of the telephone plant. A number of years showed earnings of 8 per cent or better. In 1931, 6 per cent was earned on the plant investment and in 1932 only 4.6 per cent.

Net earnings in the electric light and power industry have been very good and have shown remarkable stability. The percentage earned on invested capital has ranged from about 5 per cent to 8 per cent during the period 1912 to 1932. The average was approximately 6.5-7 per cent from 1922 to 1932. In 1932 and 1933 the figure has been around 5.5 per cent or higher.

Net earnings to plant investment has averaged less than 4 per cent in the electric railway industry since 1912. In 1932 and 1933 it was less than 3 per cent.

The manufactured gas industry has done well, at least for the years 1929-1932. Over 6 per cent has been earned on plant investment during this time.

Net earnings in the telegraph and cable field represent only a moderate return on plant and equipment, probably not over 5 per cent during the twenties. Since 1929 the return on capital invested has been drastically reduced.

An additional study[11] further shows the position of utilities. In 1929, sixty electric light, power, and gas companies earned 10.6 per cent on net worth, (net worth including book value of outstanding preferred and common stock and surplus account at beginning of year) and in 1931 they earned 8.3 per cent. A similar group of eighty-five companies having a net worth of $5,500,000,000 earned 6.4 per cent in 1932 and 5.5 per cent in 1933.

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[9] Standard Statistics Company, Inc., *op. cit.*, p. 4.
[10] *Ibid.*, p. 2.
[11] Data from *National City Bank Bulletins*.

While the Bell Telephone System had higher earnings in 1929 than did the electric power, light, and gas companies, it earned less on net worth in 1931 to 1933.

Twenty-one street railway companies earned only 0.3 per cent on net worth in 1932 and 0.2 per cent in 1933. Net profits decreased 51.7 per cent in 1933 as compared with 1932.

NET EARNINGS AND INTEREST REQUIREMENTS.[12]—Earnings of public utilities in general, except for electric railways and utility holding companies, have satisfactorily covered interest requirements and other fixed charges. A study of public utility debts shows that interest requirements were less than 50 per cent of net earnings in 1912, 1922, 1929, and 1931.[13]

Thirty-one utility companies with about $15,000,000,000 invested capital and a funded debt of $8,300,000,000 earned their fixed charges two times in 1931 and 1.7 times in 1932. Sixteen holding companies in this group, involving 60 per cent of the capital and having a funded and long-term debt of $6,000,000,000, earned their fixed charges 1.48 times in 1932. The group of ten operating companies with a total invested capital of $3,700,000,000 and a funded debt of $1,600,000,000 covered their fixed charges 2.62 times in 1932. Only two of the ten companies failed to earn their fixed charges two times or better.[14]

Interest requirements were earned approximately four times as an average by the Bell Telephone System in the decade, 1922-1931. In 1932 interest was covered 3.5 times.

The electric light and power industry as an average for the years 1922-1931 had net earnings of approximately 2.5 times their interest requirements. Net earnings were approximately 2.25 times interest in 1932.

In 1929 the manufactured gas industry had net earnings approximately three times interest. In 1931 it was 2.7 times and in 1932 slightly less.

The status of electric railways has declined during recent years. Net earnings have decreased greatly, while interest requirements have been materially augmented. Net earnings have been less than 1.5 times interest requirements for more than a decade. Full interest charges have not been earned during the years, 1930-1933. In general, the bonds of this industry are in a precarious position.

For the most part interest requirements in the telegraph and cable group were well covered until the depression arrived. How-

[12] *Supra,* n. 7.
[13] Clark, Evans, *Internal Debts of the United States,* (1933), p. 144.
[14] Standard Statistics Company, Inc., *op. cit.,* pp. 36-38.

ever, the situation has changed during recent years. In 1932 net earnings were not sufficient to meet full interest charges for the Mackay Companies, the Western Union Company, or the International Telephone and Telegraph Company.

RETROSPECT AND PROSPECT.—The major industries in the utility field have had a very favorable record as to profits. Even in our worst economic depression a large proportion of our electric light and power companies, telephone companies, and gas companies have come through with good earnings and a very substantial return on invested capital. The volume of business has been largely maintained and only slight reductions in rates have been granted to consumers. These factors have been reflected in the price and yield of utility securities. Over 50 per cent of the exclusively electric light and power, gas and telephone bonds had a yield under 5 per cent in 1932 and 1933. On the other hand traction and holding company securities occupy an unsatisfactory investment position.

Any reasonable appraisal of the outlook for the utilities would entail an analysis of many factors, taking us far beyond the scope of this book. Even with all the discussion of the rate question, valuation, competition and regulation the writer is sanguine over the outlook. Possibilities for profit are still good and with the return of reasonable business activity much of the utility industry should reap substantial returns.

Chapter XIX

TRUST INVESTMENTS IN THE CORPORATE FIELD—INDUSTRIALS

INDUSTRIAL corporations as a group form the largest field of investment of any industry in the United States. Industrials have grown very rapidly during the past few decades until today the assets of corporations in this field total approximately \$100,000,000,000.[1] Although there are many successful industrial enterprises which have high investment merit, as yet few states recognize industrial securities as suitable for trust investment.

INDUSTRIAL SECURITIES IN TRUST PORTFOLIOS.—The proportion of trust assets invested in the industrial field is larger than is generally supposed, if the investment portfolios of 196 trusts from five states may be taken as an index of the general situation. In Table LXVIII is shown the percentage of the principal of these trusts invested in industrial securities.

TABLE LXVIII

THE PROPORTION OF THE PRINCIPAL OF 196 TRUSTS INVESTED IN INDUSTRIAL SECURITIES, 1919-1932

Year	Bonds	Preferred Stock	Common Stock	Total
1919	1.6%	4.5%	12.4%	18.5%
1920	1.5	4.5	12.1	18.1
1921	1.8	4.5	14.0	20.3
1922	2.1	4.5	15.8	22.4
1923	2.5	4.5	17.5	24.5
1924	2.2	4.4	17.5	24.1
1925	2.1	4.4	17.0	23.5
1926	2.0	3.9	16.8	22.7
1927	1.8	3.8	17.7	23.3
1928	1.7	3.2	20.9	25.8
1929	2.2	3.7	22.8	28.7
1930	2.4	3.6	22.8	28.8
1931	2.8	3.1	23.5	29.4
1932	2.9	3.0	23.4	29.3

THE POLICY OF TRUST INSTITUTIONS.—There is a wide difference of opinion among trust people regarding industrial obli-

[1] *Statistics of Income.*

gations for trust investment. That they are entitled to consideration because of the underlying position of successful industrial corporations in our national economy is now admitted by a number of trust institution officials. One writer has stated that "a proportion of 20 per cent of industrial bonds and/or preferred stocks is not generally considered to be out of line."[2] In fact trust institutions have followed some such policy. For the fourteen years, 1919-1932, the 196 trusts as a composite allocated as an average 24.3 per cent of their principal to industrial securities. Such investments comprised 19.3 per cent of the aggregate principal in the inventory; 18.5 per cent in 1919; and 29.3 per cent in 1932.

It is interesting to note that industrial common stocks comprised three-fourths of the investment in the industrial field, averaging 18.1 per cent for the period 1919-1932. The percentage in this investment rose from 12.4 per cent in 1919 to 23.4 per cent in 1932, a very substantial increase. The increase, however, was primarily due to appreciation rather than to new commitments.

Preferred stocks, beginning at 4.5 per cent in 1919 accounted for over one-fourth of the investment in industrials at that time. Their relative importance declined, however, being only 3 per cent of the aggregate in 1932, or about one-tenth of the total invested in industrial securities. Industrial bonds were insignificant throughout the period 1919-1932, comprising less than 10 per cent of the proportion invested in the industrial field, and less than 3 per cent of the composite of 196 trusts.

In the inventory industrial bonds were held in forty-seven trusts and at the end in sixty-two. They comprised, for the most part, a comparatively small percentage of those trusts for which they were selected.

As for industrial stocks, both preferred and common, there was a decrease both in the number of accounts holding them and in the proportion which they comprised of the accounts in which they appeared.

THE INDUSTRIAL FIELD.—The problem of investing in industrial securities is particularly complicated because of the large number of companies and industries to choose from. Each line of industry has its own peculiar problems, and is subject not only to general economic conditions but to the vicissitudes of competition, of management, of combinations, and the changes

[2] Evans, Arthur H., "Trust Investments and Policies," *Proceedings Eleventh Pacific Coast and Rocky Mountain States Trust Conference*, 1933, p. 66.

which naturally come from year to year. Such changes are prone to be drastic in the industrial field so the investment status of each industrial group must be examined anew in the light of these new circumstances and an appraisal made of the current factors affecting its future stability. However, it is impossible to treat each line of industrial activity separately, therefore, we shall merely consider the field in general.

INDUSTRIAL ASSETS AND DEBTS.—The magnitude and relationships of industrial assets and debts for all corporations and by major groups are shown in Table LXIX.

TABLE LXIX

INDUSTRIAL ASSETS AND DEBTS FOR ALL CORPORATIONS AND BY MAJOR GROUPS, 1929 AND 1931[a]

(000,000 omitted except for ratios)

		Tangible Assets			Debts			Ratio: Current Assets To Current Debt	Ratio: Current Assets To Total Debt	Ratio: Tangible Assets to Total Debt
		Current	Fixed	Total	Current	Fixed	Total			
All Corporations	1929	$53,050	$45,137	$98,187	$15,928	$9,653	$25,581	3.33	2.07	3.83
	1931	50,152	44,082	94,234	12,398	9,825	22,223	4.04	2.07	3.83
Mining and Quarrying..	1929	2,890	7,264	10,154	975	1,037	2,012	2 96	1.43	5.04
	1931	2,762	6,633	9,395	849	996	1,845	3.25	1.49	5.09
Manufacturing	1929	31,597	28,235	59,832	7,418	5,450	12,868	4.26	2.45	4.64
	1931	31,329	28,286	59,615	6,017	5,581	11,598	5.20	2.70	5.14
Construction.	1929	1,675	857	2,532	846	350	1,196	1.98	1.39	2.11
	1931	1,536	715	2,251	580	297	877	2.64	1.75	2.56
Trade.........	1929	14,464	4,967	19,431	5,730	1,253	6,983	2.52	2.07	2.77
	1931	12,260	4,729	16,989	4,074	1,315	5,389	3.00	2.27	3.15
Service.......	1929	2,424	3,814	6,238	954	1,563	2,517	2.53	....	2.47
	1931	2,265	3,719	5,984	878	1,636	2,514	2.57	....	2.38

[a] Figures taken from *Statistics of Income*. Tangible current assets include cash, notes and accounts receivable, inventory, tax exempt investments and one-half of other investments. Tangible fixed assets include real estate, buildings, and equipment. Current debt includes notes and accounts payable. Fixed debt includes bonded debt and mortgages.

The credit position of industrial corporations as a total seem substantial. The current ratio position was strengthened, current assets being four times the amount of current liabilities in 1931 as against three and one-third times in 1929. Current assets were more than twice the total debt. This ratio had not dropped below two in any year from 1926 to 1931, the former year being the earliest for which data were inspected. Total tangible assets were 3.8 times the total debt. In 1926 and 1927 it was approximately four.

From 1926 to 1929 the current position of industrials was not weakened. In fact, the current asset-current liability ratio improved slightly. In the period 1929-1931 the credit position

of all corporations improved. Current assets decreased less than $3,000,000,000 while current liabilities decreased $3,500,000,000. For the same years the bond and mortgage debt increased $172,-000,000 while fixed tangible assets decreased over $1,000,000,000. After all the changes made in the first two years of the depression are considered current assets are still 3.83 times the total debt.

The current ratio position of each of the major divisions was stronger in 1931 than in 1929, although the service group showed practically no change. The service group is the only major division in which current assets are less than the total debt. The manufacturing industry appears to be in the strongest position with respect to credit ratios.

A balance sheet of 433 industrial corporations[3] showed a current ratio of less than five in 1929 and over six in 1932. Current assets in 1932 were 1.9 times current liabilities and funded debt.

PLANT INVESTMENT AND CAPITALIZATION.—The *Statistics of Income* does not give data on plant investment of industrial corporations. Therefore, tangible assets will be used. The total tangible assets, long-term debt and capital stock for all corporations and by major groups are given in Table LXX.

TABLE LXX

TANGIBLE ASSETS AND CAPITALIZATION OF ALL INDUSTRIAL CORPORATIONS AND BY MAJOR GROUPS, 1929 AND 1931[a]

(000,000 omitted)

			Capitalization			
		Tangible Assets	Long-term Debt	Preferred Stock	Common Stock	Total
All Corporations	1929	$98,187	$9,653	$3,859	$42,036	$66,548
	1931	94,234	9,825	9,722	39,940	59,487
Mining and Quarrying	1929	10,154	1,037	537	5,715	7,289
	1931	9,395	996	564	5,000	6,560
Manufacturing	1929	59,832	5,450	7,009	26,220	38,679
	1931	59,615	5,581	6,883	25,459	37,923
Construction	1929	2,532	350	152	732	1,234
	1931	2,251	297	132	677	1,106
Trade	1929	19,431	1,253	1,851	7,466	10,570
	1931	16,989	1,315	1,682	6,837	9,834
Service	1929	6,238	1,563	619	1,903	4,085
	1931	5,984	1,636	461	1,967	4,064

[a] Figures from *Statistics of Income*. Figures for tangible assets from Table LXIX.

[3] Standard Statistics Company, Inc., *Standard Earnings Bulletin*, July 20, 1933, p. 2.

The long-term debt was slightly over 10 per cent of tangible assets in 1931 but less than this figure for 1926-1929. Total bonds and stocks comprised only 63 per cent of tangible assets in 1931. Funded debt comprised 16.5 per cent of total capitalization and preferred stock almost the same proportion as in 1931. Common stock accounted for 67 per cent of total capitalization in the same year.

In 1931 long-term debt amounted to about 9.4 per cent of total assets in the mining and quarrying, and manufacturing groups of industries. In the construction group bonds and mortgages comprised 13.2 per cent of total tangible assets as of 1931. The long-term debt was only 7.7 per cent of tangible assets in the trade group but nearly 27.3 per cent in the service industries.

In each major division of industries, capitalization was considerably less than the total tangible assets of that division. Likewise, the total long-term debt of each division was a relatively small proportion of the total capitalization for that group. Common stock comprised the major part of capitalization.

A composite of 554 industrial corporations[4] had total assets of $33,477,000,000 and total invested capital of $31,041,000,000 as of 1932. These companies comprise approximately one-third of the capital in the industrial field. Funded debt and current debt were only 18 per cent of total assets.

Capitalization, including funded debt, preferred stock, and common stock and surplus, was $30,016,000,000, or nearly 97 per cent of total invested capital. Funded debt comprised 15.6 per cent of total capitalization (including surplus) and preferred stock 14.2 per cent. Thus, common stocks constitute a high percentage of the aggregate capitalization.

In 1927 the capitalization of 544 prominent industrial corporations was made up as follows: Funded debt 20 per cent, preferred stock 17 per cent, and common stock 63 per cent.[5] This is certainly a conservative showing. If we consider industrial enterprises individually, wide variations in capital structures may be noted. Many corporations have no funded debt and some have no preferred stock.

THE TREND OF INCOME.—The trend in gross and net income of industrial corporations as an aggregate and by major groups is shown in Table LXXI on page 266.

In 1921, for the first time in some years, gross income of industrial corporations declined. Such a drop clearly reflects the

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[4] Data on these companies from Standard Statistics Company, Inc., *op. cit.*, p. 4.

[5] Sloan, L. H., *Corporation Profits*, (1929), p. 22.

TABLE LXXI

GROSS AND NET INCOME OF ALL INDUSTRIAL CORPORATIONS AND BY MAJOR GROUPS, 1922-1932[a]

(000,000 omitted)

	Total All Corporations		Mining and Quarrying		Manufacturing		Construction		Trade		Service	
Year	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
1922....	$81,036	$3,470	$3,695	$ 6	$44,683	$2,641	$1,766	$ 39	$28,676	$695	$2,216	$ 89
1923....	98,001	4,651	4,863	—51	56,221	3,571	2,224	69	32,274	933	2,419	129
1924....	98,717	3,825	4,849	—67	53,911	2,763	2,210	91	35,115	902	2,632	136
1925....	110,747	5,199	4,925	244	60,830	3,701	2,306	113	39,847	967	2,839	174
1926....	114,157	5,081	4,548	272	62,495	3,708	2,816	109	40,938	835	3,360	157
1927....	115,146	4,151	3,837	29	63,722	3,088	3,056	112	40,944	795	3,587	127
1928....	120,872	5,154	3,589	125	67,273	3,911	2,978	100	43,204	891	3,828	127
1929....	126,949	5,636	4,048	232	72,133	4,406	3,082	108	43,494	730	4,192	160
1930....	108,317	1,109	2,999	—44	60,900	1,118	3,042	68	37,209	—88	4,165	55
1931....	82,770	—1,795	2,229	—255	44,033	—822	2,236	—30	30,593	—565	3,679	—123
1932....	49,916	—2,727	1,313	—149	23,846	—1,446	1,291	—102	20,796	—715	2,670	—315

[a] Based on figures taken from the annual *Statistics of Income*. No adjustments were made. Data for 1932 from preliminary report.

low levels of wholesale commodity prices and slow business. From 1921 gross incomes of industrial corporations had an unbroken advance to 1929. The most striking feature of this advance was the rapid growth of corporate gross incomes. The figure for 1922 was $81,000,000,000; in 1929 this figure had risen to nearly $127,000,000,000, indicating an increase of nearly 57 per cent. The precipitous drop from 1929 to 1932 reflects the magnitude of the depression and its effects upon industrial corporate gross income.

The gross incomes of the major divisions of industries followed, in the main, the trend experienced by the industry as a whole. There were two exceptions, however. Gross income in the mining and quarrying industry reached its highest level in 1925. According to gross income data for the construction group, expansion virtually reached its peak in 1927.

Since 1927 manufacturing, and mining and quarrying have shown the greatest relative decline, while the service group has shown the least decline.

The behavior of net income is more irregular than that of gross income. Although changes in gross were accompanied by changes in net, there is not an equal percentage change in the two.

The deficit in net in 1931 and 1932 was the first in considerably more than a decade. In the latter year it reached unparalleled proportions.

If the figures of net income are examined they seem to indicate that corporations were finding it exceedingly difficult to maintain in the years 1927-1929 the high level of earnings reached

in 1926. An examination of this question, however, cannot be undertaken in this book.

Net income in the various industries did not follow the general pattern. All groups, except construction, showed a considerable shrinkage in 1927. In the mining and quarrying industry net income was very irregular and reached its peak in 1926. The peak net-income year for the construction service and trading corporations was 1925. All groups reached a high point in 1929. Manufacturing, however, was the only group having a higher net income in 1929 than in any previous year.

EARNINGS AND INTEREST.—Net income of industrial corporations was ample to meet interest requirements during the years 1922-1930. It is interesting to survey the situation during the depression. A tabulation of earnings of 1,302 corporations by industries for 1931 showed 59 per cent earning net profits (income after depreciation, interest, taxes, and other charges and reserves). There was a net profit for all the corporations of $718,000,000. Of these companies 301 improved their earnings in 1931 over 1930.[6]

A further cross section of the net earnings of industrial corporations may be observed in a tabulation of 1,475 companies for the two years 1932 and 1933.[7] In 1932 these companies as a composite had a deficit, after depreciation, interest, taxes, and other charges and reserves, of only $97,156,000. These concerns were classified according to fifty-five major industrial groups and in 1932 only twenty-two of the groups showed net profits.

Earnings in 1933 showed a substantial improvement over 1932. The 1,475 corporations showed net profits of $660,655,000. Thirty-five of the fifty-five major industrial groups had net profits in 1933 against twenty-two in 1932.

A composite income account of 433 leading American industrial corporations comprising about one-fourth of the total assets of all industrial corporations has shown a substantial earnings record for the years 1927-1932.[8] Net profits were nearly eleven times fixed charges in 1927, approximately sixteen times fixed charges in 1929, about nine times in 1930, and nearly four times in 1931. Even in 1932 net profits exceeded fixed charges, but only by a slim margin. Differences between individual companies, even in the same industries, are very striking.

RETURN ON INVESTED CAPITAL.—Nowadays earning power is particularly stressed as the basis for judging the investment

[6] *National City Bank Bulletin,* April, 1932.
[7] *Ibid,* April, 1934.
[8] Standard Statistics Company, Inc., *op. cit.,* p. 2.

merit of securities. The best measure of earning power and the success of an industrial enterprise is the percentage earned on invested capital.

In a study of corporate incomes for the period 1920-1929 Nerlove[9] found that the construction industry as a whole earned a large percentage return on invested capital. Eight of the ten years showed a return of 10 per cent to 13 per cent. "The average rate of return for the manufacturing corporations was around 9 per cent."[10] The trading group also showed a substantial return, approximately 8 per cent for the ten years. The poorest return on invested capital was made by the mining and quarrying division. A deficit was shown in three of the ten years and a return of less than 1 per cent in two.

All groups, except construction, showed a deficit for 1921. During 1931 and 1932 every group showed a deficit.

A group of 433 leading American industrial corporations as an aggregate, having an average of about $28,000,000,000 invested capital for the years 1927-1932, earned an average of 6.75 per cent on this capital for those years. The percentage earned in 1931 and 1932 was small, of course, being only 0.8 per cent in the latter year and 2.8 per cent in 1931.[11]

In a group of 554 concerns, over 25 per cent, or more than 100 corporations, earned 5 per cent or more on their invested capital in 1932. Scores of companies earned 10 per cent or over for that year.[12]

The earnings of 1,302 industrial corporations, classified according to fifty-five major industrial groups, showed a 13.5 per cent return on net worth (which includes book value of outstanding preferred and common stocks and surplus account at the beginning of each year) in 1929. Thirty-six of the fifty-five major divisions of industries showed a 10 per cent return or more on net worth in 1929.[13]

These corporations had a return of 2.5 per cent on net worth in 1931. Seven of the fifty-five groups earned 10 per cent or over on net worth. Thirty-one of the fifty-five major groups showed some return on net worth in 1931.[14]

A tabulation of earnings of 1,475 industrial corporations in 1932 revealed no return on net worth. However, twenty-one of the fifty-five major groups showed some return on net worth;

[9] *A Decade of Corporate Incomes 1920 to 1929,* Ch. VII.
[10] *Ibid,* p. 41.
[11] Standard Statistics Company, Inc., *op. cit.,* p. 2.
[12] *Ibid.,* pp. 6 ff.
[13] *National City Bank Bulletin,* April, 1932.
[14] *Ibid.*

in nine of these major groups this return was 5 per cent or more.[15]

There was a substantial improvement in the earnings of these 1,475 corporations in 1933. For the year they had a return on net worth of 2.5 per cent. Sixteen of the fifty-five groups of industrials showed a return of 5 per cent or more on net worth. Some return was made on net worth by thirty-four of the fifty-five major industries.[16]

There are nine major groups of industrial corporations which showed a return of 5 per cent or better on net worth for each year 1929-1933. The figures for these nine groups of industries are presented in Table LXXII.

TABLE LXXII

NINE GROUPS OF INDUSTRIAL CORPORATIONS SHOWING A 5 PER CENT RETURN OR OVER ON NET WORTH EACH YEAR 1929-1933[a]

Number of Companies				Industry	Percentage Return on Net Worth			
1929	1931	1932	1933		1929	1931	1932	1933
18	18	21	21	Bakery	15.1	11.0	7.5	7.1
28	28	24	24	Chemicals	18.0	8.0	5.0	8.0
15	15	26	26	Confectionery and Beverages	25.0	20.3	10.8	15.0
9	9	11	11	Dairy Products[b]	20.8	12.2	6.0	4.2
21	21	22	22	Drugs and Sundries	21.9	15.6	12.6	12.3
39	39	45	45	Food Products.—Miscellaneous	15.3	8.4	6.5	9.4
43	43	46	46	Chain Stores	19.3	12.7	7.3	12.2
9	9	11	11	Stock Yards	10.7	9.3	5.0	5.5
25	25	27	27	Tobacco	14.6	14.4	13.4	8.3

[a] *National City Bank Bulletins.*
[b] Group did not earn 5 per cent in 1933.

CORPORATE DEFICITS AND FAILURES.—Throughout the period 1922-1933 a large percentage of industrial corporations reported a deficit. Sixty per cent or more of the companies in the mining and quarrying group reported a deficit for each year from 1922 to 1931 inclusive. In the manufacturing industry about 35-45 per cent of the companies had a deficit. The number had increased to over 55 per cent in 1930-1931. In the three remaining industrial groups the corporations reporting net income considerably exceeded the number reporting a deficit, except for the depression years.

Although the depression has been severe and prolonged and there has been a large percentage of companies showing a deficit,

[15] *Ibid,* April, 1934.
[16] *Ibid.*

the volume of failures has been quite small. The commercial failures as reported in Dun's *Review*[17] have not excessively increased in recent years. The liabilities of failed concerns in 1930-1933 was probably not over $1,250,000,000 greater than the amount would have been if failures had continued at the rate shown in 1928-1929.

INDUSTRIAL SECURITIES.—On the basis of earnings there are many excellent industrial securities. Although industrial bonds in general have never been regarded with great favor for investment of trust funds they possess many advantages. While the earnings are ordinarily subject to wide variations, industrial long-term debts are usually small in comparison with the value of the property. Further, freedom from regulation enables them to build up strong reserves in good times to carry them through depression periods. Available statistics do not show that there has been an excessive amount of industrial bond issues in default in comparison with the bonds in other fields.

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[17] The data for corporate and unincorporated enterprises are not given separately.

Chapter XX

TRUST INVESTMENTS AND THE BUSINESS CYCLE

THE drastic economic changes of the past few years seriously affecting the adaptability of various types of securities for trust investment have made the intelligent management of trust assets exceedingly difficult. In fact business conditions were so topsy-turvy that even the highest types of securities showed wide fluctuations in prices and many suffered irreparable damage in intrinsic value. Municipal obligations, once considered prime security, became poor risks; many railroad bonds of the highest grade barely paid interest; the rapid deflation in real estate made investments in many first mortgage obligations nothing short of fool-hardy; many foreign issues once strongly recommended by leading investment banking houses became practically worthless; the prolonged depression placed numerous industrial obligations in the realm of speculation or made them worthless.

INVESTMENTS IN THE LIGHT OF CHANGING CONDITIONS.—Choosing the proper investments from a multitude of securities, from the thousands of business enterprises in many different fields, is a particularly difficult task because each investment must be analyzed in the light of changing economic conditions. Not only must one consider specific and individual situations pertaining to a security but the cyclical phenomena of business must also be considered. The age-old theory that "good" investments once acquired should be kept is no longer practicable today when the whole investment situation, as well as the relative value of every security is subject to continual fluctuation. An investment which is good today may not be good tomorrow. Not only is the credit of individual corporations and municipalities constantly changing, but the whole economic background, against which all investment values are reflected, oscillates in varying degrees of periods of prosperity and periods of depression.

NATURE OF THE BUSINESS CYCLE.—Due to the close relationship existing between economic and business conditions and investment values, the investor must of necessity keep in close touch with these conditions. A beginning is made when he recognizes that business is not solely a game of chance but that

there are orderly movements in successive contractions and expansions of business activity.

The existence of the business cycle may be noted from observing that from time to time in our history certain groups of events have occurred with some degree of regularity and that they have shown considerable relationship. When business is good profits increase and enterprises expand. New capital is secured, credit is expanded, employment increases and we have evidences of general prosperity. As business gathers momentum it eventually goes into what is known as a boom period, a time of large profits for an increasingly large number of companies.

The rising period of prosperity and boom period creates optimism and risks are underestimated. Production is accelerated for purchasing power has been greatly increased. There is a rise in debts and fixed charges. Credit expands and interest rates are increased. News of the day is encouraging, or is so painted by most newspapers and magazines. There would seem to be a redundancy of evidence that there were any economic dangers.

The upward spiral of business prosperity, however, is usually accompanied by factors that denote financial strain which eventually lead to a wave of liquidation and a business depression. Some such evidences are high call loan rates, high time loan rates, large volume of brokers' loans, great expansion of commercial bank credit, large amount of loans of member banks on security collateral, high rediscount rates at Federal Reserve banks, and shrinking bank deposits.

Business and economic activity sooner or later reaches a tempo which cannot be sustained unless we have reached a new era of performance and the old norms are no longer applicable. We rarely ever have a sudden transition in fundamental economic factors, however. Thus we have experienced declines and severe depressions after boom periods. During the down-swing of business and economic activity there is usually a drastic decline in commodity prices, business activity is sharply contracted, earnings shrink and purchasing power is reduced; inventories decline, defaults, receiverships and bankruptcies are vastly more numerous, changes in business structures occur, there are devaluations of large estates, business careers are abandoned, interest rates decline and capital becomes almost a drug on the market. The ranks of the unemployed become augmented, the burden of existing debts tends to increase, the tax burden grows heavier, and existing prices shrink enormously. Pessimism permeates the whole atmosphere.

TYPES OF BUSINESS FLUCTUATIONS.—A study of statistical

data reveals three separate and important types of movements in business. The first important change in business to be noted is the secular trend. It is the trend of business activity connoting a steady increase in volume of business, industrial development, financial activity, expansion of trade and technological development. Such long-term trends represent periods of fifty or one hundred years.

The second type of change in business activity is known as seasonal variations. It is the change in business activity which occurs mainly with the changes of the seasons. It appears frequently and represents weekly or monthly changes in economic and business data. The seasonal changes in business continue to occur each year irrespective of other changes.

BUSINESS CYCLES.—The third type of business movement is known as the business cycle. It represents changes in business activity which cannot be explained by secular and seasonal changes. The business cycle represents variations in business involving alternating periods of prosperity and depression. It has been defined as "recurrences of rise and decline in activity, affecting most of the economic processes of communities with well-developed business organization, not divisible into waves of amplitudes nearly equal to their own, and averaging in communities at different stages of economic development from about three to six or seven years in duration."[1]

Persons' study reveals certain fundamental facts regarding the business cycle. These facts are as follows:

> During the period of 654 months for which we have counted the month-to-month changes, February 1875-July 1929, inclusive, there were 56 months of trough, 109 months of recovery, 299 months of prosperity and 190 months of recession.
>
> The trough of November 1910-January 1912, lasting 15 months, was unique in length. The troughs of major depressions ranged from 5 to 7 months except in November-December 1914, when war orders stimulated recovery; October 1896, when the free silver issue was defeated; and December 1878, when specie payments were resumed. The troughs of minor depressions lasted only one month except in November 1910-January 1912 during the "trust-busting" and anti-railroad activities of the Federal and State governments; and in July-October 1898, during the Spanish War.
>
> Recoveries from major depressions lasted from 12 to 16 months, except in 1915 and 1879 when war orders and phe-

[1] Mitchell, W. C., *Business Cycles: the Problem and Its Setting,* (1927), p. 468.

nomenal crops shortened the interval to 10 and 9 months, respectively. Recoveries from minor depressions lasted between 1 and 5 months, with the usual figure at 3 months.

Periods of "prosperity" in the United States have lasted from 4 to 44 months. The longest intervals were those of October 1879–July 1883, after specie payments had been resumed, prices were rising and crops were unusually bountiful; the war period of November 1915-July 1918; and November 1904-July 1907, a period of rising prices, bountiful crops, and industrial consolidations. Very short periods of prosperity lasting 4 to 7 months followed the major depressions of 1894, 1908 and 1921.

The longest period of recession on record, 34 months, accompanies the return, in 1876-78, to specie payments. The decline was briefly interrupted by a good crop and price situation in 1877 and bumper grain crops, though at lower prices in 1878. The second longest intervals of recession was from November 1912 to October 1914, partly a war decline. Of the remaining recessions, six lasted from 10 to 16 months and eight lasted from 3 to 7 months.[2]

DIFFERENT CYCLES.—In general, there is a definite business cycle. That is, most business situations tend to vary at about the same time and in the same direction. More correctly speaking, however, the business cycle proper is merely the algebraic sum of many different cycles. For example there are many different cycles of different lengths for various agricultural products, manufacturing products, building construction, prices, security prices, etc. Probably no two of the hundreds of cycles are alike. In order to properly understand and forecast the business cycle we must be able to analyze accurately the components of the business cycle.

DURATION AND AMPLITUDE.—The belief that there is a certain periodicity in cycles is not generally accepted today. They are of a more generalized affair of varying length. Apparently the average period of a business cycle is about forty months. Mitchell's studies show that from 1790 to 1923 the United States passed through thirty-two cycles which averaged a little less than four years, the most common period being three years. Dr. Thorpe has investigated many business cycles and from his data we may set forth briefly some pertinent figures regarding prosperity and depression. According to Dr. Thorpe the number of months of prosperity was 39.3 per cent of the total, the depression months accounted for 36.8 per cent, while the aggregate of

[2] Persons, W. M., *Forecasting Business Cycles,* (1931), p. 203.

revival and recession was only 23.9 per cent. Persons' study shows that "during the period of 654 months, February 1875—July 1929, inclusive,"[3] recovery and prosperity represented 63 per cent of the period of the 654 months while recession and the trough represented 37 per cent. During this period normal business, that is, business whose index was above the 100 line, prevailed for 62 per cent of the time, subnormal business accounting for only 38 per cent.

The degree of variation in cycles is quite pronounced. Production and trade seldom extend below 80 per cent of the average. In the recent depression it was below 70 per cent. In periods of prosperity business rarely rises above 120 per cent of the average. In certain lines of business and finance, however, much wider deviations may be found.

THE BUSINESS CYCLE AND INDUSTRIES.—It is undoubtedly true that certain industries have cyclical movements which do not conform with the indices of general business; and certain industries are more drastically affected by a business depression than others. Even in periods of general prosperity there are some industries experiencing slow business or are in a state of depression. In fact rarely does a large percentage of business enterprises gain satisfactory profits.

The effects of the business cycle upon different industries vary greatly. Certain industries are more cyclical than others. For example, the industries producing basic materials and heavy equipment have a much greater amplitude in business activity than certain other industries which are favored by greater stability of earnings. During a depression we find such industries as steel, copper, building materials, machine equipment, etc., very slow and earning little or nothing. Some companies in such industries show substantial losses; some even fail. Railroads which have fixed charges that are large in relation to gross revenues will experience great difficulty in a severe depression.

There are many companies in certain lines of industries which show profits even in the dullest years of a business cycle. Scores of companies earned a substantial return on their investment during each year 1930-1933, which is probably the worst depression period of our history. Food companies, chemicals, dairy products, confectionery, drugs, chain stores, tobacco, and bakery enterprises represent lines of business that have been less affected by the depression. Certain groups of the utility industry have likewise continued to show good profits.

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[3] Persons, *op. cit.*

In other words the state of the business cycle is a more important consideration for certain industries than are the conditions within the industry itself. In all cases it is an important factor confronting all investors.

THE BUSINESS CYCLE AND SECURITIES.—The close relationship that exists between the prices of various groups of securities and economic conditions makes it imperative that the trustee watch carefully the movement of the business cycle if he is to carry out any intelligent investment policy. The kaleidoscopic movements of business affect all types of securities. The effect of the business cycle on fixed income-bearing securities, like bonds and preferred stocks, differs from that on equity securities, like common stocks, or on convertible and participating bonds; to a large extent their prices vary in opposite directions. During the up-swing of the cycle, business is profitable; business enterprises show constant gains in both gross and net earnings. At this time, the risk of purchasing all securities is less than in the preceding stages, for the greater the general business prosperity the larger the earnings, and the more certain are interest payments and dividends. The contrary is true when business is declining and we are in a depression. The actual risk of investing is greater owing to decreases in business activity and earnings, purchasing power, debt burdens, falling prices, declining inventory values, failures, and unemployment.[4]

As a result the fluctuations in market value, by reason of changes in the estimate of risk, will be greatest in the low-grade securities and least in the high-grade securities. For example, bonds, like well-secured rails, utilities, and some industrials, and high-grade municipals and governments, will decline with the up-swing of the industrial cycle, and will be lowest in price at the top. Such bonds will rise in market value with the down-swing of the pendulum, and will be highest during the succeeding depression unless greatly affected by the risk factor. Securities of greater risk will be quoted lowest during a depression. They will rise in value with the up-swing, as optimism returns, as prices of commodities, wages, and profits rise, until highest at the top.[5]

A study of the movement of security prices for nearly half a century shows an important relationship between cyclical movements in business and security prices. Yet, these observations do not justify the conclusion that all security prices will always move with the trend of business. There are many exceptions.

[4] Dewing, A. S., *Financial Policy of Corporations,* (1926), p. 1214.
[5] *Ibid.*, pp. 1216-21.

That not all types of securities move in unison with the gyrations of the business cycle has been verified in a number of statistical studies. It is easily demonstrated that in both the stock and bond groups a number of individual securities do not conform to the group fluctuation. Even an entire industry may fail to follow the general trend of business activity. But securities of the majority of companies usually fluctuate at all times in close sympathy with business conditions. Thus the various phases of the business cycle have an important bearing upon any investment policy.

INVESTMENT RISKS.—In formulating an investment policy, the major investment risks—the credit risk, the interest rate risk, the purchasing power risk, and the risk of fluctuation in the market values of securities—should engage the attention of the trustee in handling trust assets. If every trustee, who bought "gilt-edge" bonds of a certain kind would actually hold them to maturity, without having to sell, and if during this period he did not have to account for his acts, on the basis of current market value, he could regard fluctuation in the market value with indifference. But there is no class of investment that meets all these conditions. For, to all practical purposes, every investment must be made with respect to a time limit, more or less definite, or with respect to the undesirability of a decline in the market value.

Where the fluctuation of securities in market price is due to changes in the general level of interest rate there is present an example of the interest rate risk. For example, New York Central 3½s, 1997, a trustee investment of the highest grade, once sold at 116, but within a twenty-five year period sank to sixty-one. At sixty-one this was still a high grade investment with negligible credit risk, but its decline in value was primarily due to a shift in the general level of interest rates. Suppose that when the price was at 116, a trust had been established to end definitely within twenty-five years, that this security was held during the life of the trust, and that, at the end, the trustee was forced to sell for sixty-one. Such a procedure is not uncommon in the handling of trust assets and illustrates the folly of attempting to develop any "permanent" investment policy.

FUNDAMENTAL ASPECTS OF THE BUSINESS CYCLE.—If some definite rules could be laid down with respect to the probable occurrence of the business cycle, an investment policy could be carried out on a scientific basis. Thus, the trustee would know exactly the time most auspicious either to purchase or dispose of certain classes of securities. Of course, no such certainty of procedure is yet possible, but the trustee can observe certain

fundamental phases of the cycle to his advantage. The two most outstanding factors to be observed are the periods which elapse between "peaks" in security prices and their low points, and the symptoms that appear to indicate that the business curve has reached, or is about to reach, the turning point.[6] If actual light can be obtained on these two groups of data with respect to the business cycle then the trustee can act with a greater degree of intelligence in investing trust assets.

THE BUSINESS CYCLE IS FREQUENTLY NOT CONSIDERED.—Unfortunately many trustees appear to pay too little attention to the movement of the industrial cycle in the investment of trust assets. A number of trust institutions still follow the practice of choosing certain securities of specified qualifications, and holding them until the termination of the trust, regardless of the ups and downs of the business cycle during the interim. While theoretically choosing a security to fit the particular investment requirement, some institutions still buy securities en bloc, and distribute them ad libitum among the various trust accounts, irrespective of the needs of the trust or the business situation.[7]

THE PROBLEM OF "LEGALS."—The oscillation of business from periods of prosperity to periods of depression gives trustees particular concern over the question of selecting, retaining or disposing of trust investments. Especially is this true with respect to retaining or disposing of securities which are threatened with losing, or which have already lost their legal status. This problem, however, has not disturbed savings bank to any large extent. Statutes usually give the superintendent of banks discretionary authority to require the sale of bonds which have ceased to be legal, thus their orderly sale may be effected within a reasonable time, so as not to unduly depress the market. For the trustee the problem is different. Statutes do not prescribe any definite course of action, and court decisions on this point are not wholly satisfactory as to a procedure to be followed.

The collapse in railroad bonds, particularly, has been a source of grave concern to trust institutions and the situation would have been far worse but for the moratorium granted in various states. Without regard to the inherent investment characteristics of a particular railroad security, the statutes of some states pro-

[6] Willis, H. Parker, and Bogen, Jules I., *Investment Banking,* (1929), p. 322.

[7] That these are not mere generalizations may be noted from a study of individual trusts which have been in operation a fair length of time. It should be stated in all fairness, however, that this criticism does not apply to the majority of the trusts analyzed in this study.

vide simply than certain railroad bonds are legal if fixed charges have been earned one and one-half times for at least five of the six fiscal years next preceding, which must include the last one. When the income appeared satisfactory, adequate earning power seemed all that was necessary, but the earning power of many railroads was so affected that issues of only a small part of those formerly qualified within the legal formula seemed capable of preserving their status. Consequently, there has been a great deal of sacrificing of railroad securities. The most unfortunate phase of the situation is that many issues, not qualified under the one and one-half requirement, are yet highly proper investments. For example, it is presumed that the service charges on such outstanding railroad obligations as New York Central 3½s, of 1997, which would probably never be disturbed even if the road went into receivership, are assured for years. It is a bit ironical that trust institutions should have to dispose of such securities while the law permits them to retain a mortgage on questionable special purpose real estate.

Many questionable securities today, if left alone, would probably continue to pay interest and come back in value. Yet the provisions of the laws in many states, designed to insure liquidity of trust investments, have in reality created a situation wherein trustees fairly vie with one another in the unloading of such securities. Such statutes, governing legal investments for savings banks and trust institutions, designed to protect the beneficiary's interests, give some protection in the case of inexperienced trustees, but often limit the activities of the more competent ones. The inadequacy of such artificial restrictions is evident from the growing number of defaults in legal securities. By limiting trust investments to certain prescribed groups, ofttimes of doubtful value, these laws have in some cases worked to the detriment of the very beneficiaries which they were designed to protect. Indeed the law of trusts is frequently a hindrance to changes in investment to cope with changes brought about by the business cycle.

Chapter XXI

LIBERALIZING TRUST INVESTING

THE management of trust property today is vastly different from what it was a century ago under a more simple economy. From a passive receptacle of title, a trustee has now become the active manager of property, the wise counsellor, and the guardian of minors and incompetents. In olden times, those who had the benefits of property also carried the burdens, but in the modern industrial order this is becoming less and less true. Property, today, does not consist merely of goods and chattels, but in large part of intangible wealth; the advent of the corporation has brought a multiplicity of forms of personal property. The wide distribution of its ownership has increased the problems of management; the methods of doing business are now so complex that intelligent management is a prerequisite of economic survival. The increase in the burden of property management, with the growing recognition of the ease with which it can be separated from its benefits, is undoubtedly responsible for the recent remarkable growth of trusteed property.[1]

NEED FOR LIBERALIZING TRUSTEE AUTHORITY TO INVEST.—The greater responsibilities attendant upon the management of modern trust property have given rise to the need for more adequate trust investment powers. To manage property effectively, the fiduciary must have adequate investment powers to act as the occasion demands.[2] If the trustee is to exercise judgment in the light of new circumstances arising in a changing economic world he must be given powers beyond the necessity of giving effect to

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[1] Headley, Louis S., "Clarifying the Laws Governing Trustees and Executors," *Trust Companies,* Vol. 52 (Mar. 1931), p. 305; see also Rose, Dwight C., *Scientific Principles of Investment Management:* Ch. I, "Evolution of the Surplus," Dice, Charles A., *The Stock Market,* Ch. I, "General Characteristics of the Market for Stocks"; Willis, H. Parker and Bogen, Jules I., *Investment Banking,* Ch. VII, "History of Investment Banking."

[2] Headley, Louis S., "Executors' and Trustees' Powers," *Proceedings Twelfth Mid-Winter Trust Conference,* Feb., 1931, p. 88; Reilly, Edward J., "Today's Problems in Trust Investment Management," *Proceedings Thirteenth Mid-Winter Trust Conference,* Feb., 1932, p. 118; Stevenson, W. J., "Statutory Powers, Duties, and Responsibilities of Trustees," *Proceedings Thirteenth Mid-Winter Trust Conference,* Feb., 1932, p. 149; Trott, R. H., "Trustee's Need of Wider Power," *American Bankers' Association Journal,* Vol. 20 (Mar., 1928), p. 694.

the dead hand, or complying with antiquated laws or ill conceived statutes. Without such powers the trust *res* may suffer from lack of intelligent management and the beneficiary may fail to receive the proper benefits. Without adequate authority to invest, the trustee is frequently hindered in the execution of the modern managerial type of trust. If he acts beyond his powers, he becomes personally liable; if he fails to act within the limits of his authority, he becomes liable for negligence. Thus, it is felt that broader fiduciary authority to invest would benefit all parties concerned. Modern industry demands such a revision for the speedier transaction of business; the beneficiary demands it for his own profit; while the trustee himself, who acts at his peril in the absence of express authority, demands it for his own protection if he is to properly manage the trust property.[3]

CONFUSION AND LACK OF UNIFORMITY IN LAWS.—Unfortunately much of the uncertainty and confusion that surrounds the administration of trusts has not yet been cleared away despite laudable attempts in this direction. The investment management of trusts today is still encumbered with delays and uncertainty due to many diverse laws, the conflict of existing case rules, or the doubtful application of court decisions. In some states trust institutions operate under laws which have not been revised for generations; while in others there prevails a more enlightened policy which attempts to alter the law in keeping with changing economic conditions. Further, there is often a veritable potpourri of laws that serve only to confound the trustee in investing.

The laws of the various states differ particularly with regard to what constitutes legal investments, in the delimiting of which many of them show an unwarranted provincialism or a downright lack of appreciation of the problem. In fact, the inconsistencies of statutes, narrow legal lists and technical requirements are so numerous and probably so well known as to hardly need repeating.[4] A few examples will suffice. Relatively few states

[3] Rosenshine, A. A., "Social and Legal Aspects of Trust Service," *Trust Companies,* Vol. 53 (Aug., 1931), p. 231; Rose, Hugh B., "To Be Or Not To Be In Handling Trust Investments," *Trust Companies,* Vol. 45 (Nov., 1927), p. 599; Headley, *op. cit.,* supra, n. 1.

[4] Reilly, Edward J., "Formulating a Sound Code Governing Legal Investments for Trust Funds," *Trust Companies,* Vol. 54 (Feb., 1932), p. 233; "Status of Municipal Obligations as Trust Investments," *Trust Companies,* Vol. 54 (Mar., 1932), p. 329; "Real Estate Obligations as Legal Investments for Trust Funds," *Trust Companies,* Vol. 54 (April, 1932), p. 473; Stephenson, W. J., *op. cit.;* Fox, Edward J., "The Need for Further Unification of Trust Laws and Practices," *Proceedings Twelfth Mid-Winter Trust Conference,* Feb., 1931, p. 102; Bogert, George G., "The Movement for a Uniform Trust Administration Act," *Proceedings Thirteenth Mid-Winter Trust Conference,* Feb., 1932, p. 159.

permit a trustee to purchase investments outside the jurisdiction in which he is acting; a small number allow the practice in particular cases; while some states have approved investments in mortgages on land in adjoining states. In a few states, the constitution forbids a trustee to invest in the stocks and bonds of private corporations; in other states statutory laws allow him to lend on personal security; in one state a trustee may not buy bonds of another state lacking certain specified qualifications, but he may buy bonds of a foreign country or government which merely pledges its full faith and credit; while in another it is permissible to lend trust funds on the unsecured promissory note of a state resident, provided the note matures in not more than twelve months and does not exceed $10,000. The statute of one state provides for investment in foreign and municipal issues without limitation as to the amount which may be held in any trust but it restricts the investment in rail and utility issues to 25 per cent in any one trust. In one state no railroad bonds are legal at any time but railroad stocks, selling at or above par, are legal provided they meet certain dividend requirements.

Without regard to fundamental investment characteristics the statutes of a number of states have specified that certain railroad obligations will be legal provided fixed charges have been earned one and one-half times (or have set up some similar requirement). Thus, intelligent discrimination has been hindered. Many of these issues had to be sacrificed during the recent period of adverse conditions or else makeshift legislation had to be created to extend the legality of such issues. The latter was the choice, but if the statutes must be suspended under adverse conditions of what value are they as safeguards? In other instances the law on trust investments contains many complexities and interpretative possibilities.[5] Varying and confusing terms pertaining to almost every type of investment may be found if one should survey the details of the various statutes.[6]

The multiplicity of conflicting laws, opinions and technical provisions has made the necessity of revising legislation governing the duties of fiduciaries in the investment of trust funds painfully apparent. Revision is necessary not only in the interest of simplicity and clarity, but to enable the trustee to keep pace with changing economic conditions.

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[5] The New Jersey Statute is a good example.

[6] See statutes of the various states in the State and Municipal Compendum of the *Commercial and Financial Chronicle;* Prentice-Hall Trust Service. These services give a comprehensive and reliable presentation of the state laws controlling the investment of trust funds.

LIMITATION OF DESIRABLE INVESTMENT OUTLETS.—An increasingly serious problem confronting trust institutions today is a possible shortage of desirable investment outlets. With the increase in the magnitude of trust business throughout the past decade this question has been of particular significance, especially in those states where the trust institutions have been operating under strict statutory limitations, as in New York. The situation at the present time is even more acute since the unprecedented collapse in values has had a devastating effect upon many of the so-called "legals."

While there has been no unanimity of agreement among trust officials regarding the situation either before 1929 or since that date, nevertheless there is ample evidence to show their intense interest in the matter. For years, strenuous efforts were made in New York to have certain public utility securities placed on the legal list, while in other states efforts have likewise been made to broaden the list of legals. Then, too, the principle of allowing certain equities to be chosen for trust portfolios has been advocated.

Such movements have come, probably, from an unsatisfactory experience with the investments to which the institutions were restricted. Such action also recognized the persistent encroachment by the total assets of trust funds upon the available high quality investments within the legally sanctioned fields. By this it is not intended to imply that an actual dearth of investments existed, but rather that the number of trusts and the volume of trust assets received by trust institutions increased so rapidly as to result in considerable carelessness in the selection of quality-investments within the authorized classes. Perhaps this was partly due to the absence of other outlets. Had certain trust institutions been allowed, prior to 1929, to invest in other fields than those prescribed by law, it is conceivable that they might have placed in those media some of the funds which instead went into real estate obligations—now in jeopardy—or into railroad bonds, likewise in a most precarious position.

It is not known just what the exact volume of trust investments was in 1900 or 1932, compared with the total tangible wealth of the United States for the same years, but there is ample evidence to indicate that there has been throughout the period from 1900 to 1932 a continually rising ratio of trust investments to national wealth. The estimated national wealth of the United States was $88,517,000,000 in 1900.[7] It is doubtful if

[7] *Statistical Abstract of the United States,* 1933, p. 258.

the aggregate personal trust business of all trust institutions in the United States was greater than $1,000,000,000 at that time.[8] Thus, slightly more than 1 per cent of our national wealth was trusteed with trust institutions. The National Industrial Conference Board estimated our wealth at $247,300,000,000 in 1932.[9] The total personal trust property of all trust institutions was probably thirty odd billion dollars for that year;[10] equivalent roughly to 12 per cent of our wealth. Thus, trust assets of corporate fiduciaries stood, in 1932, approximately thirty odd times as high as in 1900, while the estimated total national wealth of the United States was less than three times as great.[11]

A phenomenal increase in personal trust assets of trust institutions has taken place since the early twenties; within this time the growth has been striking not only in the volume of testamentary trusts, but also in living trusts, life insurance trusts, agency, and other types of accounts.[12] There is no reason to doubt that the rate of growth of trust institution investments will outstrip the growth in national wealth. In the first place a larger and larger proportion of wealth is being trusteed and secondly trust institutions are receiving an increasing percentage of trusteed property. Thus, it is quite conceivable that trust institutions will be forced by the accumulation of vast trust assets, which must be trusteed, to seek still wider investment outlets.

LIBERALIZING TENDENCIES.—The growing recognition of these limitations in the administration of the modern managerial type of trust has for some years given rise to a distinct tendency to liberalize trust investing. This tendency has manifested itself chiefly in two main directions: (1) wider discretionary powers in trust investments, and (2) statutory changes and amendments to include a wider list of authorized investments.

BROADER POWERS OF TRUST INSTRUMENTS.—From a survey of over 400 trust instruments[13] ranging over a period of some thirty years it may be said there was some tendency to give the trustee wider investment powers. The instruments made since

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[8] See Chapter I.

[9] *The Conference Board Bulletin*, VII, 5, p. 34.

[10] See Chapter I.

[11] National wealth was four times as great in 1929 as in 1900.

[12] See Chapters I and III.

[13] The author examined about 140 New York trust instruments which were created prior to 1920 and about seventy which were created since that time. Nearly 100 Ohio instruments were examined, approximately sixty were in existence before 1920 and forty were created after that date. About eighty Massachusetts instruments were studied, two-thirds of them being set forth prior to 1920. No instruments were examined in Illinois or Missouri other than those of the trusts analyzed.

1920 were more liberal in this respect than those created twenty or thirty odd years ago. This is particularly true in New York, where in the earlier period the vast majority of trust instruments restricted the investments to legals or to a prescribed list, or otherwise circumscribed the trustee's investment powers.[14] Today trustees are frequently given some such investment powers as follows: "Trustee shall receive, hold, manage, convert, sell, assign, or reinvest and otherwise deal with the moneys and properties constituting this trust estate as it, in its discretion, shall deem to be for the best interests of the beneficiaries hereunder to the same extent that the grantor himself might do." Further, the trustee is authorized "to invest the trust funds in such properties as it shall deem advisable even though they are not technically recognized as legal investments" in the particular state.

The public has been complying with the principle that the trustee should be given ample investment powers to enable it to show the best results and then to hold it accountable for good faith, diligence and reasonable intelligence. This change is probably due to the influence of trust institutions and to a growing recognition of the situation by grantors whose confidence in the work of trust institutions is increasing more and more.

A significant aspect of the tendency to liberalize trust investing is the development of the commingled trust fund plan.[15] However, these plans are almost completely predicated upon the basis that the trust instrument must contain provisions authorizing the trustee to mingle the trust fund. During the past six years this has been accomplished to no little extent. There are some seven trust institutions operating one or more types of commingled trust funds. In practically every instance the participating trusts have authorized the practice. There are no public data regarding the number of trust instruments which have included broad provisions sanctioning the commingling of the fund but available, though incomplete, data[16] show that it is an important aspect of the tendency to liberalize trust investing.

STATUTORY CHANGES.—Statutory changes toward liberalizing trust investing through widening the list of legals are typified by the alteration in 1928 of New York's conservative legal investment list to include certain public utility obligations, equipment

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[14] See Chapter IV.
[15] See Chapter III.
[16] Ward, Rodman, "Appeal for New Trust Business in Operation of the Co-Mingled Fund," *Trust Companies,* Vol. 55 (Sept., 1932), p 289; Barclay, George C., "Valuable Experience with Comingled Funds for Trust Estates," *Trust Companies*, Vol. 56 (Feb., 1933), p. 183; see also *Trust Companies,* Vol. 52 (Jan., 1931), p. 31.

trust obligations, and additional railroad and municipal bonds, thus adding approximately $2,800,000,000 to the investment field for savings banks and trust companies.[17] Before this amendment was passed, for almost thirty years savings banks and trust companies in New York State had been forced to invest a large per cent of their funds in real estate mortgages, thus depriving themselves of the possibilities of investing in other sound securities. In recent years because of the upheaval and unfortunate experiences in the investment market further suggestions have been made for additions to the media of investment for trust assets. A particularly interesting example was the proposed amendment to the Savings Bank Law of New York State to admit certain collateral and debenture issues of the American Telephone and Telegraph Company. It is held that these unsecured obligations are better security than any but the choicest mortgage bonds, and have a liquid market second only to United States government bonds.

In Oregon, investment of trust assets were formerly limited to United States obligations, Oregon bonds, and bonds of any state in the Union, with specified restrictions; in notes, bonds, or mortgages on real estate in certain states where the loan was not to exceed 50 per cent of the valuation. Now, however, the legal list includes bonds of any corporation listed on the New York Stock Exchange, such as railroads, telephone, electric light, power, and water companies, where no default in principal or interest has occurred in five years; and bonds of Great Britain and Canada, payable in United States dollars, provided no default has occurred in the five years immediately preceding the investment. Also under the new law, trust institutions are given the authority to issue split trust certificates on any investments they may own. This provision takes care of the comparatively small balances in trust accounts requiring investment—for the trust institution can issue participating certificates either in bonds or mortgages—but its main advantage is in the splitup of large mortgages among various trusts.[18]

Pennsylvania, likewise, has launched a program to liberalize its legal list for savings banks and trust institutions.[19] Since 1873, a provision in the state constitution has prohibited the investment of trust funds in bonds or stocks of any private cor-

[17] "Legal Investments Liberalized in New York," *Trust Companies,* Vol. 46 (March, 1928), p. 317.

[18] See the statutes of Oregon; also "Oregon's New Trust Legislation," *Trust Companies,* Vol. 52 (Jan. 1931), p. 809.

[19] Littleton, W. G., "Shall Pennsylvania Increase Its Classes of Legal Investments?" *Trust Companies,* Vol. 51 (Nov., 1930), p. 659.

poration. Because of the relatively low return on Federal, state, and municipal bonds, this constitutional bar has in practice limited trust investments in Pennsylvania to real estate mortgages, which have proven less desirable during the present demoralized conditions. At the legislative session of 1929, a resolution was approved by both houses, providing that Article 3, Section 22 of the Constitution should read: "The General Assembly may, from time to time, by law prescribe the nature and kind of investments for trust funds to be made by executors, administrators, guardians and other fiduciaries."

At the legislative session of 1931 this amendment was again presented for concurrence, and being approved for the second time, it was submitted to the vote of the people in 1933, when it was approved. The legislature now has authority to enact more liberal laws in regard to the investment of trust funds.

About the middle of the twenties Virginia revised its trust investment statute, adding to the list state bonds of other states, municipal bonds of cities outside of Virginia, urban real property mortgages in cities within the fifth federal reserve district, and certain railroad bonds. More recently certain common stocks have been added. Within the last six or seven years a wide list of states—Ohio, Pennsylvania, New Jersey, Connecticut, Minnesota, Wisconsin, Tennessee, Florida and Louisiana to mention only a few—have liberalized by statute the rules with respect to trust investments.[20]

COMMON STOCKS.—In line with the tendency to liberalize the investment of trust funds, more and more attention has been paid to the wider fields of corporate stocks. It is contended that the shortage of investment outlets of high quality and the limitations of a narrowly restricted list of legals make it imperative that trust institutions turn to stocks as an outlet for trust assets. Common stocks, however, have generally been condemned as investments for trust assets because they were believed to be speculative, from the view points of both safety and yield. Yet there has been a growing feeling that some common stocks possess investment characteristics equal to those of many bonds.[21]

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[20] No attempt is made to catalogue all the changes in a given state or to enumerate all the states which have made considerable changes in their statutes tending to liberalize trust investing. That these changes are significant may be seen from comparing the state statutes of 1934 with those of previous years.

[21] Rose, Dwight C., *The Practical Application of Investment Management* (1933), Part II; Dewing, A. S., *The Financial Policy of Corporations,* rev. ed. (1926), Book VI, Chapter IV. Some views of trust men are indicated in the Year Book of the Trust Division of the American Bankers' Association, 1933-34, pp. 32, 209.

THE COMMON-STOCK THEORY.—The common-stock theory, in general, is predicated upon the belief that common stocks, with respect to market value and income, are superior to bonds as long-term investments. The proponents of the theory, however, do not claim that any random list of common stocks purchased at any time will always in the future, irrespective of market and economic conditions, be superior to a list of high-grade bonds chosen at the same time. It is not asserted that common stocks are always to be preferred to bonds, or that bonds have no place in an investment program. The basic assumption in the theory is that if the country continues to grow and to progress essentially as it has, a well chosen portfolio of common stocks will over long periods of time yield greater return and give greater market value than will high-grade bonds.

STUDIES ON THE RELATIVE MERITS OF STOCKS AND BONDS.—The advantages of common stocks as long-term investments are supported by a number of studies made in recent years. The first outstanding study of the kind was that of Smith[22] who undertook to measure, by statistical analysis, the comparative merits of bonds and common stocks as long-term investments.[23] Twelve tests were made of stocks and bonds each ranging from seventeen to twenty-two years. These tests covered various periods in our financial history from 1866 to 1922. High-grade bonds were selected while the stocks chosen were those which Smith believed would have attracted the investor's attention at the time.

Eleven of the tests resulted in a clear advantage for common stocks while only one showed bonds to be superior. The hoary belief that only bonds were sound investment was dispelled and in consequence a great impetus was given to investments in common stocks.

A few years later Van Strum set forth the results of a study embodying eighteen tests made to measure the performance of bonds and common stocks covering various periods from 1873 to 1924.[24] Van Strum's analysis also disclosed substantial advantages for common stocks, thus reiterating Smith's conclusions.

From the time Smith's and Van Strum's studies appeared until the crash in 1929 a host of writers took up the theme. Numerous discussions, both pro and con, appeared in periodicals

[22] Smith, Edgar Lawrence, *Common Stocks as Long Term Investments*, (1923).

[23] The initial idea of the theory was first suggested in this country by Professor Irving Fisher and others. See Fisher, Irving, ed., *How to Invest When Prices Are Rising,* (1912).

[24] Van Strum, Kenneth, *Investing in Purchasing Power,* (1925).

and books dealing with the relative merits of stocks and bonds as investment. In the meantime, equity issues had gained ascendency in a rising stock market. Common stocks were widely accepted not only by individual investors and investment trusts but also by institutional investors—trust institutions, insurance companies, banks, universities, and others.

When we entered a period of slow business and a falling security market in the fall of 1929, many investors lost faith in the common stock tenet. Smith, however, came to its defense stating that "even for those who were fully invested in common stocks at the time of the break, there is no great reason for concern, for it remains true that the long-term trend in the value of a diversified list of common stocks is gradually upward and there is every reason to believe that this trend will continue upward—so long as the country continues to make industrial progress."[25] A year later Sloan reiterated practically the same idea.[26]

THE DISSENTERS.—There were many writers during the twenties who took exception to the common-stock theory, attacking both common stocks as investments and the methods set forth in the studies made by proponents of the theory.[27]

A book on Investment and Speculation appeared in 1931 in which the writers defined investment as follows: "Investment is parting with the control of wealth (usually funds) during a fixed period of time, for the consideration of a fixed periodic rental, commonly called interest."[28] It was then stated that "when one is grounded in this principle one cannot go far astray in his thinking on the subject of investment."[29] *Ipso facto,* then, common stocks are not investments, either in theory or fact, but are speculations.[30] It is doubtful if the treatise starting with such a premise is entirely convincing to serious students of the question.

RECENT APPRAISAL OF EQUITY ISSUES.—An abridged extension of the Smith tests was recently made. Three of his tests which he traced from "1901 through 1922, were continued from

[25] Smith, Edgar Lawrence, in an address before the Corporate Fiduciaries Association of New York on "The Cult of the Common Stock—Now," quoted in *Commerce and Finance*, February 19, 1930.

[26] Sloan, Laurence H., *Everyman and His Common Stocks,* (1931).

[27] The best known critics were Bradley D. Nash, Arthur H. Herschel, Walter E. Lagerquist, and Lawrence Chamberlin. The list should also include a number of officials of insurance companies and trust institutions.

[28] Chamberlin, Lawrence, and William Wren Hay, *Investment and Speculation,* (1931), p. 8.

[29] *Ibid., loc. cit.*

[30] *Ibid.,* p. 57.

that point to the end of 1933."[31] Account was taken of both income and market value with the attendant results again in favor of common stocks.

A recently published study, or rather a continuation of one previously made, by Rose has a significant bearing upon this subject.[32] Rose's study sets forth an analysis of the investment experience of the "Dow-Jones selection of industrial stocks, railroad stocks, and railroad, public utility and industrial bonds, as currently used and published in their averages throughout" the period, 1901-1932. The investment experiences of the Dow-Jones selection of samples were shown on four different bases, all showing an overwhelming advantage for the industrial stock fund. The experience of the railroad stock fund was the poorest of the three groups.

With these synthetic records of investment experience as a basis, Rose said that "in spite of the greater than anticipated deflationary movement of the past three years, the experience of a diversified group of industrial stocks over the past thirty-two years continues to justify fully their inclusion in the portfolio as long-term investments."[33]

In this study Rose also made an analysis of the portfolios and investment experience of the twenty-five largest fire insurance companies from 1903 to 1931. The twenty-five companies as a composite carried as an average, for the period 1903-1931, 23 per cent in common stocks, 8 per cent in preferred stocks, 48 per cent in bonds, and 21 per cent in miscellaneous investments. Analyzing the individual companies he notes that the most successful company carried on the average, for the same period, 1903-1931, 41 per cent in common stocks, 21 per cent in preferred stocks, 26 per cent in bonds and 12 per cent in miscellaneous. The least successful company carried on the average for the same period, 4 per cent in common stocks, 20 per cent in preferred stocks, 70 per cent in bonds and 6 per cent in miscellaneous. The best company realized an average annual investment accomplishment of 5 per cent while the poorest company realized only 3 per cent.

These two companies had approximately $10,000,000 of invested assets in 1901. Each management was charged 4.2 per cent annually, the riskless rental value of capital, for the use of the funds. The most successful company showed a business

[31] Harold, Gilbert, "King Midas and His Common Stocks," *Barron's*, April 30, 1934.
[32] Rose, *op. cit.*
[33] *Ibid.*, p. 32.

profit, above riskless rent, of $3,500,000 at the beginning of 1932, while the poorest company, after allowing for the riskless rent, showed a business loss of $4,400,000.

Rose concludes that the "investment experience of the twenty-five largest fire insurance companies clearly indicate that common stocks have been the most profitable medium of investment carried by them over the last thirty years, even when complete allowance is made for currently depreciated market values."[34]

During the past several months Messrs. Kellog and Kilbourn have submitted tabulations of a study covering all listed bonds and stocks on the New York Stock Exchange, for the period, January 6, 1922 to January 6, 1933, allegedly a complete cycle.[35] They generalized as follows: "That only one bond issue became wholly worthless, while over 10 per cent of the common issues joined the list of valueless extinct securities, clearly proves the bondholder is in an intrinsically more secure position than the stockholder." Thus, according to a subhead of the article, the common-stock theory is disproved.

FURTHER CONSIDERATION OF THE QUESTION.—The numerous studies of common stocks as long-term investments have emphasized their advantage over bonds with respect to market value, income and maintenance of purchasing power of the original funds. In spite of the sound basis of common stock investment, let us briefly consider the nature of common stocks in comparison with other types of securities.

The common stockholders' position in the capital structure of a corporation is that of residual owner of the business. All other types of security holders, except preferred stockholders, are creditors of the corporation. Thus, common stock may comprise the sole capitalization of a corporation, or it may represent only a proprietary interest which is subordinate to the priority of bonds and preferred stocks.[36] It is a factor of considerable importance to the common stockholder to know whether or not the company has important prior obligations.

Bonds and preferred stocks receive a fixed income, consequently investors in these instruments lose when commodity prices are rising. In a period of rising prices the dollar will purchase a smaller amount of goods and in consequence a fixed in-

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[34] *Ibid.*, p. 50.

[35] Kellogg, H. Dudley, and Radcliffe E. Kilbourne, "Bonds Generally More Satisfactory Than Stocks as Long-Term Investments," *The Annalist*, Feb. 9, 1934.

[36] On this basis bonds appear to be a more conservative investment than common stocks. While from a legalistic point of view these differences are valid, it is doubtful if they are so real when actual cases are studied.

come will decline accordingly. Thus, bonds measured in terms of commodities will tend to decline. On the other hand, the common stockholder profits when prices rise, because business earnings are usually increased during such a period, the assets of the business appreciate, and it becomes easier to pay debts when the value of money is depreciating.

Another factor in favor of the common stockholder, independent of the changing value of money, is the long-term growth of the country and its influence upon the trend line of earnings. The advantages accruing from this growth redound primarily to the benefit of the common stockholder. The bondholder and preferred stockholder reap little from this secular trend development except that their income and principal are made more safe.

The corporate policy of American corporations has also been beneficial to the common stockholder. The normal growth of industry has provided ample room for expansion which has been financed largely out of current earnings. Thus, as current earnings are profitably invested from year to year the earning power as well as the asset value behind common stock has grown at an accelerated pace. Undoubtedly the investment of these huge corporate surpluses into businesses has given rise to greater intrinsic worth of common stocks. This is especially true in the industrial field where the practice has been most commonly followed.

Granted that one could choose the right stocks at the right time at the right price, all might be well. But what are the right stocks, what is the right time and what is the right price? Irrespective of the gyrations of the business cycle, there seems to be a definite law of growth, of different stages in the development of the industry; the beginning; the period of rapid growth, increasing competition, and smaller profits; and the period of declining earnings. The trend of the industry and its stage of development are fundamentally important.

ATTITUDE OF TRUST OFFICIALS.—Despite the various studies pointing toward the value of common stocks as investments, officials of trust institutions are not yet agreed upon the suitability of common stocks as investment media for trust funds. The predominantly conservative attitude of trust companies in this country on this point is typified in the symposium on common stocks held at the Eleventh Mid-Winter Trust Conference, February, 1930. Of the seven speakers, six representing trust institutions in Atlanta, Cleveland, Detroit, Chicago, Denver, and San Francisco, stated that it was contrary to the policy of their institutions, unless specifically directed by the trust instrument,

to place any portion of the funds committed to their care in common stocks. Only one, Mr. Leon M. Little, Vice-President of The New England Trust Company of Boston, favored the selection of common stocks for the portfolios of trust accounts.

One trust official taking a very conservative stand on the question has gone so far as to say that "trust instruments should be regulated by statute and limited to mortgage securities, where the definite lien of a creditor obtains on specific property that can be seen and its value and earning capacity properly appraised. Common stocks have no place in the trustee system of investment, which must stand firmly upon the rock foundation of conservatism."[37] In similar vein Mr. H. F. Wilson, Vice-President of the Bankers Trust Company of New York, stated before the Mid-Winter Trust Conference, February 1932, his belief that common stocks have no place in trust investments. His bank discourages them, he says, not only because of their greater risks but because it is not possible to obtain satisfactory protection.

There are, however, a few outspoken pleaders for the liberalization of trust investing through the selection of common stocks. One of the leading supporters of this doctrine is Mr. C. Alison Scully, Vice-President of the Manhattan Trust Company in New York who says: "Common stocks as trust investments are no longer a theory on which it is pleasant to ruminate. They are in fact and practice suitable investments for trust estates. . . . But we must be highly discriminating in the selection of stocks before we buy them, and once bought we must watch them with a minute and vigorous attentiveness."[38] Likewise, in answer to the question whether the trust door should be thrown open to admit stocks as approved investments, Mr. Paul A. Sinsheimer, Vice-President of the American Trust Company, San Francisco, has this to say: "It would seem advisable to broaden the field of investment for trust funds and to include

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[37] Lathrop, A. L., "Should the Present Legal Restrictions Upon the Investment of Trust Funds Be Liberalized?" *Proceedings Eighth Regional Trust Conference,* Aug., 1930, p. 30. The case for conservatism is further exemplified in the following: Irving, W. J., "Case for Conservatism," *Burroughs Clearing House,* Oct., 1931, p. 30; Ridgeway, A. B., "Danger Signals and Safety Zones in Non-Legal Trust Investments," *Trust Companies,* Vol. 53 (Nov., 1931), p. 569; Horr, R. A., "The Meek Shall Inherit the Earth—Safety First in Trust Investing," *Trust Companies,* Vol. 55 (July, 1932), p. 23; Bennett, R. A., "Real Estate Mortgages Retain Preeminence as Investment for Trust Funds," *Trust Companies,* Vol. 55 (July, 1932), p. 55.

[38] "Common Stocks as Trust Investments," *Proceedings Tenth Mid-Winter Trust Conference,* Feb., 1929, p. 40.

additional bonds and preferred stocks of long established record and merit. . . . We may ask for stocks the same cautious scrutiny as we urge for bonds. If there be no universal sanctity in stock, just as truly we admit there reposes no sacred security in a bond. . . . Many of the bonds that are listed as eligible for trusts are notably less worthy of investment confidence than some high-grade preferred and common stocks."[39]

WHAT INVESTMENT EXPERIENCE REVEALS.—Although the predominant opinion of trust officers is theoretically antagonistic to common stocks as outlets for trust assets, the data collected upon actual investment experience in five leading cities, New York, Boston, Chicago, Cleveland, and St. Louis show that this opinion is only partially followed in practice. It is true that a number of trusts disposed of all their common stocks and that many others reduced the proportion so invested. But on the other hand, Table XXVII shows that the number of trusts containing the various types of common stocks were not greatly reduced at the end compared with the beginning. The average period for the 196 trusts from the time they were received by the trust institutions until the last year for which data were collected was approximately seventeen years. Thus, after having supervised particular trusts for so long a period it would seem as though there had been plenty of opportunity for trust officials to rid the accounts of common stocks if they had desired to follow such a policy. In a composite chart, combining the investments of trust institutions in these five cities on a relative dollar basis, these facts stand out: from the very beginning of the trust accounts to their termination, common stocks constituted a major portion of the investments in the portfolios; starting in the inventory at 38.5 per cent of the total dollar value, the average for the fourteen years, 1919-1932, was 33.2 per cent, and in no single year did the proportion in common stocks fall below 30 per cent. Combining both preferred and common stock holdings, the aggregate constituted 45.3 per cent of total investments in the inventory and 39.8 per cent in 1932.

[39] Sinsheimer, P. A., "Should Trust Funds Be Invested in Common and Preferred Stocks?" *Trust Companies,* Vol. 49 (Oct., 1929), p. 475; see also, Trott, R. H., "Trustees Need of Wider Powers," *American Bankers' Association Journal,* Vol. 20 (Mar., 1928), p. 694; Andrews, H. N., Flexibility or Legislative Straight-Jackets in Investment of Trust Funds," *Trust Companies,* Vol. 48 (Mar., 1929), p. 413; "Symposium on Common Stocks as Trust Investments," *Trust Companies,* Vol. 50 (Mar., 1930), p. 431; Lersner, V. A., "Legals and the General Public," *Barron's,* Aug., 1931, p. 12; Sept. 7, 1932, p. 22; Spaulding, Geo. S., "The Banker Wrestles with His Investment Problems," *Trust Companies,* Vol. 55 (Sept., 1932), p. 247.

It might be contended, in defense of such procedure, that the trust institutions in question were required by the trust instruments to retain such securities in the trust portfolio. In no case, however, was this true. There was some selling or switching of stocks[40] but on the whole it appeared that trust officials held corporate stocks in trust portfolios at their own discretion.

PREFERRED STOCKS.—As we have seen, numerous studies have been made to determine the relative investment merit of common stocks and bonds, but less attention has been paid to preferred stocks as long-term investments. Until recently, what studies had been made were usually to the detriment of preferred stocks in favor of common.[41] To determine the relative value of industrial preferred stock as a class, Dewing made a study of every industrial preferred stock offered to the public from 1880 to 1920. All issues of less than $100,000 were excluded, likewise those which disappeared or had no recent quotations. All told, there remained 1,477 separate issues, representing approximately $4,878,000,000 of cost to American investors. This entire group, says Dewing, had declined by January, 1923, to approximately $3,678,000,000, or almost exactly three-fourths of the original issued price.[42]

To test these results, he made a further examination of the different industries represented by these 1,477 preferred issues. He divided the industries into thirty-four groups, and compared the relative success of the preferred stock issues in each group. Only one group of the lot—the steel companies—showed an enhancement of value to the original purchaser, but this was less than 5 per cent; all other groups lost. Dewing analyzed the successful issues to see if the large apparent yield from these securities was sufficient to compensate for the losses in principal. He stated that, "after allowing for the cessation of dividends on the large proportion of the issues that failed, the net return on the group as a whole was probably less than that on a random selection of medium-grade bonds . . . as a group they illustrate a poor investment."[43]

A more recent study by the Industrial Securities Committee of the Investment Bankers Association is also unfavorable to

[40] See Chapters X, XI, XII.

[41] Harsfield, Mona M., "Is Preferred Stock Preferable?" *Barron's*, Nov. 28, 1932, p. 5.

[42] Dewing, A. S., *Financial Policy of Corporations*, (1926), Book VI, Ch. II, p. 1200.

[43] Dewing, A. S., *op. cit.*, p. 1203. The data of this study may be found in an article by A. W. Woodworth, who prepared the original figures, *Barron's*, Feb. 14, 1927.

preferred stocks."[44] Here, however, the investigation was confined to preferred stock issues of relatively small industries. Selecting Boston as a test city, the Committee studied all preferred stocks publicly offered from 1925 to 1929 inclusive, eliminating stocks of well-known companies, and those with bonds ahead of preferred stocks, leaving only twenty to be considered. About half of these firms were incorporated in Massachusetts; the other half, from other states, was made up of varied types of business, excluding rails and public utilities. Of the twenty issues studied, four (from the textile group) paid no dividend up to June 25, 1932, and none of the four had a sinking fund. Assuming the investment of approximately $100 in each security at the time of issue, the total would have been $2,033; at the current market price as of June 1932, it was worth only $1,225. Of the twenty firms examined, ten had sinking funds based on a percentage of the earnings, one on the amount of stocks outstanding, one on both the percentage of earnings and the amount of stock outstanding, while eight had none at all. In spite of this poor showing, it was the opinion of the Committee that "an investment of this type cannot be considered more unsatisfactory than a similar investment made in securities of other classes giving a similar high return at the time purchased."[45]

Some writers have condemned preferred stocks as investments. For example, Badger says: "As a class preferred stocks, particularly those of industrial companies, are the least desirable of all securities. This is particularly true of non-cumulative issues, while participating or convertible issues may be classed as more desirable than common stocks, where the rights are liberally given. There are many who hold that preferred stocks are undesirable, because they have all the weaknesses of bonds, with none of their advantages; and all the weaknesses of common stocks, with none of their advantages."[46]

To test just such conclusions, W. G. Rodkey made a study of preferred stocks as long-term investments.[47] Using January 2, 1908, as a starting point, he assumed that a certain sum was invested in each security of each company. "Each test included the securities of only ten companies at any one time."[48] The market price of these investments was traced up to January 2, 1932. The preferred stocks were first divided into two groups:

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[44] *Investment Banking,* June 25, 1932, p. 277.
[45] *Ibid.*
[46] *Investment Principles and Practices,* (1928), p. 227.
[47] *Michigan Business Studies,* IV, 3, 1932.
[48] *Ibid.,* p. 5.

industrials and rails. Then these were further classified as follows: the first was a group of preferred stocks constantly preceded by bonds (Tests 1 and 2—industrials and rails); a second group included preferred stocks sometimes preceded by bonds (Tests 3 and 4—industrials); while a third group included preferred stocks not preceded by bonds (Tests 5 and 6—industrials).

When the tests involved both common and preferred stocks it was assumed that $1,000 was invested in the common stock of each company and that an equal amount was invested in each preferred stock. "In the tests involving bonds an additional $10,000 was assumed to be invested in the bonds of the same companies divided equally among the ten companies."[49]

"The average annual return on the common stock over the twenty-four year period was $1,146; on the preferred, $849; on the bonds, $587. On the basis of the original investment, each of $10,000, this gives an annual rate of 11.46, 8.5, and 5.87 per cent respectively."[50] Test 2, dealing with rails, showed an average annual return on the common stock of $620.24, or 6.2 per cent; on the preferred, $427.56, or 4.27 per cent; on the bonds, $446.56, or 4.46 per cent.[51]. "In both of these tests the preferred stocks showed a heavy loss of capital in 1932."[52] In the railroad test, all three types of securities made a poor showing, but bonds the worst and common stocks the best.[53]

In Group II, Test 3, dealing with industrials, the average annual return on the common stock was $981.40, or 9.81 per cent; on the preferred, $851.30, or 8.51 per cent.[54] In both classes of securities the original principal was greatly impaired.[55] In Test 4, industrials having no funded debt, the average annual income on the common stocks was $1,480.50, or 14.81 per cent; on the preferred, $796.78, or 7.97 per cent. While there was an appreciation of 98 per cent on the common, the original principal invested in the preferred was seriously impaired.[56] Combining the average annual dividend and the average annual increase the result was a return of 18.89 per cent on the common and 6.72 per cent on the preferred. Despite this satisfactory income return, preferred stocks made a poor showing for the long-term, for on January 2, 1932, from 30 per cent to 50 per cent of the

[49] *Ibid.*, p. 11.
[50] *Ibid.*, pp. 14-15.
[51] *Ibid.*, p. 16.
[52] *Ibid.*, p. 17.
[53] *Ibid.*
[54] *Ibid.*
[55] *Ibid.*, p. 18.
[56] *Ibid.*, p. 19.

original capital had disappeared. Judicious selection would have made a better showing, says Rodkey, but the conclusion is inevitable that "preferred stocks in general should be avoided where preceded by bonds."[57]

The results of the tests referred to above seem to bear out the general opinion that preferred stocks are poor investment media. . . . "True," says Rodkey, "if the same results were obtained with tests confined to preferred stock not preceded by bonds." In Group III, Test 5, therefore, results from preferred stock as senior security were considered. Here, the average annual income received on the common was $2,478.55, or 24.79 per cent; on the preferred, $862.75, or 8.63 per cent. There was an appreciation of 262.79 per cent in common stock values, and 10.36 per cent increase in market value of the preferred.[58] To check these results, Rodkey made another test (Test 6) choosing the companies on the basis of their preferred stock activity, excluding those with bonded indebtedness. Results show an average annual income on the common of $1,740.49, or 17.40 per cent; on the preferred, $1,030.89, or 10.31 per cent. There was an appreciation of 66.63 per cent in common stock values, compared with a 11.11 per cent increase in the preferred—thus Tests 5 and 6 check closely.[59]

In both tests involving bonds, not only did preferred stocks fare badly, but a considerable portion of the capital invested in bonds was lost. In the first four tests, two, preferred stocks of both industrials and rails, made a very poor showing in safety of principal. In Tests 1, 3, and 4 the average annual return was satisfactory, but severe capital losses occurred in each case. In Tests 5 and 6, however, where preferred stocks were senior securities, there was appreciation in capital value. Such investment results indicate that industrial preferred stocks, not preceded by bonds, possess investment characteristics quite different from the general run of preferred stocks, and that they appear to meet the most exacting tests. Undoubtedly there are exceptions to this rule. There are a number of preferred stocks which are high-grade investments even though they are preceded by bonds, and some are poor even when there are no bonds.

SHOULD TRUSTEES PURCHASE STOCKS?—Although it is undoubtedly true that a goodly number of corporate stocks possess sound investment merit, there is still a question whether a trustee should purchase such securities without the authority of the trust

[57] *Ibid.*, pp. 20-21.
[58] *Ibid.*, p. 23.
[59] *Ibid.*, pp. 23-24.

instrument or statute. The majority of the courts have held with New York that such investment is unwarranted, but the Massachusetts Courts have held that this type of investment may or may not be justified, depending upon the circumstances. Both States stress the obligation to be diligent and prudent, to invest, not to speculate, but differ in the application of these principles. If it were true that all stocks are speculative, and less secure than real estate mortgages, or government and municipal obligations, then the greater certainty of the latter might compensate for the smaller yield, but such is not the case. Present conditions have proved that many corporate stocks are much safer investments than some presumably high-grade bonds.

TRUSTEES SHOULD HAVE ADEQUATE POWERS.—In the light of the constantly shifting economic scene which makes one type of security good today but poor tomorrow, if trust investing is ever to be anything more than a haphazard, hit-or-miss affair, it is highly necessary that trustees be given adequate powers to select those securities which are suitable for trust investment, and to change them when conditions warrant change. However, the present requirement of responsibility and good faith in the execution of their duties as trustee should remain unchanged.

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